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Asset Sale Transaction

www.ewhsba.com
262-796-1040
Bottom Line - We Love Small Business™

Seller

Structure:

- Seller retains current business entity

Advantages:

- Seller gets capital gains tax treatment on what is allocated to Goodwill, as compared to Fixed Assets which are taxed at ordinary rates.

Other Considerations:

- If most of the purchase price is assigned to Goodwill a lower purchase price will sometimes be negotiated because it increas-es the favorable tax treatment to the seller and decrease the tax benefit to the buyer.

Buyer

- Buyer sets up a new business entity.
- The purchase price is allocated between Goodwill and Equipment
- Assumes no Liabilities From Previous Company Purchasing
- Buyer gets to deduct purchase price as expense
- If most of the purchase price is assigned to equipment a higher purchase price will sometimes be negotiated because it reduces the tax benefit to the seller and increase favorable tax benefit to the buyer.

Seller Balance Sheet & Income Statement

Cash	100
Fixed	
Asset	-85
GW	-15

Buyer Balance Sheet & Income Statement

Cash	-100
Fixed	
Asset	85
GW	15

Depreciation (Ex: Is 5 years)	-17
(Over the equipment useful life of 3,5,7,10 year etc.)	
Amortization (Over 15 yr)	-1

For illustration purposes only. Consult with your tax advisor to determine the tax impacts based on your situation.

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Stock Sale Transaction

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Bottom Line - We Love Small Business™

	Seller	Buyer
Structure:	Buyer buys the existing business entity. A new entity is not established.	
Advantages:	• Seller gets capital gains tax treatment on entire purchase price.	• A lower purchase price may be negotiated or factored into the purchase price because...
Disadvantages:		• Buyer Cannot deduct any of the purchase price. • When buy stock you assume all liabilities of prior company or possible lawsuits for prior actions of company. • Seller has to pay back with after tax dollars! For example: If seller in 25% tax bracket has to make $133 profit to have $100 left after taxes to pay for it.

Seller's Personal Balance Sheet & Income Statement

Cash 100	
	Stock -100

Buyer Personal Balance Sheet & Income Statement

Cash -100	N/P
	Stock 100

Depreciation -0
Amortization -0

NO DEDUCITION!

For illustration purposes only. Consult with your tax advisor to determine the tax impacts based on your situation.

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Deferred Compensation Buy Out Option

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Structure

- Existing Business Entity Remains in place
- Used in Succession Plans with Partners or Employees
- Value of Company is Split between Stock Valuation and Deferred Compensation or Goodwill paid to retiring owners
- Valuation of Deferred Compensation can be set at time of retirement or it can be based on future revenues
- All Social Security taxes are paid in one year at time of retirement on Deferred Compensation that is to be paid In the future, saving on social security taxes. Future payments are not subject to social security or Medicare.

Advantages

- Current Employees can buy company stock at a lower valuation amount
- Amounts paid to retiring owners are with after tax dollars
- Company can deduct Deferred Compensation as it is paid
- If Goodwill is involved it will be deducted and amortized over 15 Years and is taxed at capital gain rates to the seller.

Disadvantages

- Amounts paid to retiring owners usually are paid with cash flow from future operations
- Therefore payments depending on new owners maintaining growth and profitability

For General Understanding only. Consult with your tax advisor to determine the best option for selling your business.

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Employee Stock Ownership Plan (ESOP)

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To Be a Candidate

- Need a management team running the company
- Will have $30,000 -$75,000 + fees a year for annual maintenance of the plan, annual valuation and audit, plus initial set up fees are usually range from $75,000—$125,000
- Poor for small companies (typically under 10-15 employees) and companies that are not or do not anticipate making a profit
- Need to have substantial operational cash flow

Reason ESOPs are used

- Succession planning of the owners
- Alternative to selling to a 3rd Party
- Reward the people who helped build the company
- Provide options for the owners to remain in the business in a capacity if they choose
- Personal and philosophical reasons

Advantages to Seller

- Contributions to the plan are tax deductible, generally up to 25% of total eligible payroll of plan participants
- Sellers of closely held C Corporation can defer capital gains taxes on the sale to an ESOP (though several requirements apply)
- Profits attributable to the ESOP in an S corporation are not taxable at the federal and usually state levels. Furthermore profit distributions to the ESOP can offset costs and do not apply to the 25% deductions limit above

Advantages to Employees

- Employees pay no tax on what is in their accounts until they actually receive a distribution, and could continue deferring tax by rolling the distribution into an IRA or other retirement plan
- Employees share in the profits & growth of the company

This handout is based on the information in the book—Understanding ESOPs by the National Center for Employee Ownership by Corey Rosen and Scott Rodrick and is for General Understanding only. For more information consult with your tax advisor and an ESOP expert to determine the best option in selling your business.

Structure

- Set up a Trust Fund to acquire and hold company stock
- The plan is governed by a Trustee to act as the plan fiduciary, normally appointed by the Board of Directors
- Employees almost never contribute to the plan; instead, contributions are funded by the company as a benefit
- Shares and any other contributions are generally allocated to employee accounts based on a equitable formula. Discretionary approaches, like performance assessments, are not allowed
- Employees obtain vesting rights over time, as the loan is repaid to the seller. If an employee is terminated his/her account balance is distributed
- Governed by many of the same rules that cover 401(k) plans, deferred profit sharing plans, pension plan, and other retirement plans though they are more complex than other retirement plans, and do not allow as much flexibility as less tax favored approaches to sharing ownership

- The ESOP can borrow money itself with a guarantee from the business, and can acquire other companies
- Company can contribute...
  - Shares directly
  - Cash to buy shares,
  - Cash to the Trust or pay dividends or distributions on shares held by the Trust
- Or the trust can borrow money to buy the stock from the seller, while the company can then repay the loan through contributions to the plan
- Remember, contributions to the plan are tax deductible, generally up to 25% of total eligible payroll of plan participants

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