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8 Key Steps to Selling Your Business

Follow these steps on valuing your company, negotiating the deal, and creating a sales agreement.

This year, some 700,000 American businesses will be sold. Most will be small and mid-sized businesses like yours. If you, too, are thinking of selling, consider these practical steps for making the process go smoothly.

1. Determine a Realistic Price Range

If you price your business too high, you'll scare away buyers. If you price it too low, you'll risk selling at a bargain basement discount. Your goal is to figure out a range that's realistic.

Pricing a business is both an art and a science. There are several methods you can use -- and then maybe blend the results. For example, you can base the price on the value of the business's assets, and add in a sum for the goodwill the business has developed. Or you can see what comparable businesses in your industry and locale have recently sold for. Or you can use an industry formula (for example, a value based on the number of units sold annually or a multiple of average earnings) that will help set a price range.

2. Understand the Tax Consequences

Taxes can take a huge bite out of the money you receive for your business. It pays to know just how big that tax bite will be -- and to try to lower it if possible. But be careful: taxes can get complicated. You'll probably need help from a CPA or other tax expert.

Your tax bill will be influenced by two key factors: How your business is legally set up and -- in the case of a corporation or LLC -- whether you're selling the assets or the entity. Sales of all sole proprietorships and almost all partnerships are asset sales. So are the sales of many corporations and LLCs.

In an entity sale, you sell all of the corporate stock in the company or all LLC members' membership interests. The buyer winds up owning the entity itself. In that case, the stock or membership interests are treated as capital assets. This means the gain is taxed at the low, long-term capital rate (assuming you owned the stock or membership interests for more than a year).

In an asset sale, you allocate the sale price to the various assets -- for example, furniture, equipment, supply contracts, the business name -- and you classify the assets in seven IRS classes, such as inventory, other tangible property, and goodwill. The gain from property in some classes is taxed at ordinary income rates. The gain from property in other classes is taxed at the long-term capital gain rate, if owned for more than a year.

3. Prepare for a Sale

The getting-ready process, of course, includes sprucing up your business premises -- everything should be attractive and orderly. But more important is getting your numbers in good shape. Consider recasting your tax-return numbers for prospective buyers. This can involve, for example, adding back to your profits discretionary expenses such as:

- medical insurance for you and your family
- travel and entertainment
- conventions and trade shows
- expensive cars owned or leased by the business
- club memberships
- subscriptions to magazines, newspapers, and electronic services
- continuing education expenses, and
- salaries and bonuses paid to family members who work in the business.

- For instance, let's say you enjoy travel so you've been attending trade shows at attractive locations. You've deducted the cost as legitimate business expenses -- lowering your tax bill, but also lowering the bottom line.

A buyer needs to understand that the travel is discretionary. If it's eliminated, the business will show more profit for its new owner. In recasting your tax numbers, you're not deceiving either the IRS or prospective buyers. You're simply pointing out that the buyer may prefer not to spend money on some of these items in the future, even though you've taken perfectly proper tax deductions for them.

4. Seek Potential Buyers

If your business is well known, word that it's for sale may be enough to bring prospective buyers to your doorstep. Or, possibly someone close to you -- an employee, a relative, a friend, a supplier, or a customer -- could be an interested and logical prospect.

But finding buyers may not be easy. More likely, you'll need to reach out to a bigger pool of potential buyers. This often includes putting ads in newspapers, in trade publications, and on business-sale websites.

You may want to engage a business broker to reach more buyers -- though you'll pay a substantial commission for the broker's services. Sometimes, too, you need keep a low profile in your marketing efforts to avoid alarming customers and suppliers. An intermediary such as a broker can help keep information from leaking out prematurely.

5. Negotiate Your Deal

Once you attract an interested buyer, you need to work out the terms of the sale. Here are some key issues:

- Will you sell your business entity or just its assets?
- Will you keep some of the assets (a car or truck, perhaps) that are currently being used in the business?
- Will the buyer pay you in one lump sum or make installment payments?
- In an installment sale, how large will the down payment be and how long will the buyer be given to pay off the balance?
- After the closing, will you work for the buyer, either as an employee or an independent contractor?
- Will the buyer require you to sign a non-compete agreement that limits your right to work in your current industry?

6. Sign a Sales Agreement

Once you've worked out the key terms with the buyer, you need to put the deal in writing. Among other things, you'll need to list all of the assets the buyer is purchasing and the value you will assign to those assets for tax purposes and any business contracts the buyer is assuming, including business leases. Your sales agreement should also include protections that assure you'll get paid the full sale price.

In an installment sale, it makes sense to require the buyer to have a spouse or other cosigner guarantee payment of the balance owed. And, for sure, you'll want to retain a security interest in the business until the sale price is fully paid. You may even find it prudent to take a lien (a second mortgage) on the buyer's home or other real estate.

If you attempt the first draft of the sales agreement yourself, have it reviewed by a business lawyer to make sure you've covered all the bases.

7. Plan for the Closing

The closing is the meeting at which you transfer the business to the buyer. To reduce the chance of last-minute hassles, make a checklist of all the papers you'll be bringing and all that the buyer is expected to bring. While every sale is different, here's a list of common documents and items that you may need to bring with you.

- Alarm codes, computer access codes, and safe combinations
- Asset allocation statement (IRS Form 8594)
- Bill of sale or transfer documents for license, real estate, and vehicles
- Cashier's check

- Consent of entity owners to sale of assets
- Consulting contract (independent contractor agreement)
- Covenant not to compete (noncompete agreement)
- Customer lists
- Employment contract
- Escrow agreement for post-closing adjustments
- Insurance certificates for the policy covering secured assets
- Keys to file cabinets, premises, and vehicles
- Mortgage or deed of trust
- Owners' manuals for business equipment
- Promissory note
- Security agreement
- Statement regarding absence of creditors
- Supplier lists
- Title insurance commitment
- UCC financing statement

8. File Paperwork With the IRS

After the sale, you and the buyer need to complete IRS Form 8594, Asset Acquisition Statement and file it with your tax returns for the year in which the sale took place. You and the buyer should fill out the form together, allocating the purchase price among the assets purchased and classifying the assets among the various IRS categories, and file duplicate copies of the form. 

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