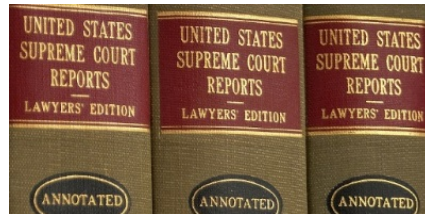




**SUFFOLK ACADEMY OF LAW**  
*The Educational Arm of the Suffolk County Bar Association*  
**560 Wheeler Road, Hauppauge, NY 11788**  
**(631) 234-5588**



# **MERGERS AND ACQUISITIONS**

## **FACULTY**

**Ken Pischel, Fractional CFO**  
**Kyle Griffith, CBI, DM, AP**  
**Christine Malafi, Esq.**

**Moderator: Karen Tenenbaum, Esq. LL.M (Tax) CPA**

**January 27, 2022**  
**Suffolk County Bar Association, New York**

Like us on:



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**Within 10 days of the course you attended, your CLE Certificate will be ready to view or print. Follow the instructions below:**

1. Go to SCBA.org
2. Member Log In (upper right corner)
3. If you **do not** know your username or password, click the area below and enter your email that is on file with SCBA. Follow the prompts to reset your username and password.
4. After you log in, hover over your name and you will see “Quick Links”. Below that you will see:
  - a. My SCBA
  - b. My CLE History
  - c. Update My Information
  - d. Update My Committees
5. Click on **My CLE History**, you will see the courses you have attended. Off to the right side you will see the Icon for certificates. You are now able to download the certificate, print it or save it. You may go to your history and review the courses you have taken in any given year!
6. **CLE certificates will no longer be mailed or emailed.** Certificates will be available within 10 days after the course.



## Ken Pischel - Fractional CFO

Ken Pischel is the founder and Managing Member of Dynamic Business Consultants LLC, a firm that provides financial consulting services to multiple businesses in the areas of financial operations and strategies. Located in Northport, NY the firm services clients in the tri-state New York area.

Dynamic Business Consultants assumes the role of part-time CFO and strategic business consultant assisting companies in both growth and crisis mode. Managing core business needs such as domestic and International planning, cash flow planning, proper policy implementation for customer and vendor relationships, loan facilities, and internal budgeting procedures; the goal is to make cost-effective decisions, using budgeting tools, profitability models, risk/reward analysis, financial statement analysis, and forecasting while measuring operational efficiencies to maximize labor, product and service utilization. Ultimately, providing structure for better decision process' through collaboration.

Mr. Pischel is a graduate of Hofstra University where he was awarded a BBA in marketing and an MBA in accounting. Recognized as a top 40 Long Island Business Executive under 40 by Long Island Business News he is an accomplished public speaker and author of several articles on business strategies. In addition, he is a former adjunct professor at Stony Brook University School of Business where he taught Business 220, Business Decisions Sciences.



**Kyle Griffith** is a Managing Partner and Principal of The NYBB Group and NYBB Commercial Real Estate, Inc.. For over ten years, he has helped small and mid-sized businesses in need of merger and acquisition and business sales services. Kyle specializes in the HVAC, Trucking, and Distribution industries, but has lent his expertise to clients in a broad range of sectors.

Throughout his career, he has owned and operated several businesses. These include a family-owned printing and shipping company; various online retail and service-based businesses; a package forwarding company; and a consulting firm. These experiences have helped him hone his business development, operations, and marketing skills.

Kyle has a solid background in sales and marketing. He is also highly skilled at implementing successful marketing strategies for business owners seeking to effectively buy or sell a business in today's market. Kyle provides top-class negotiation and representation for his clients and executes proven techniques to maximize a company's selling price and facilitate a faster sale. He takes pride in consulting with small business owners and finds fulfillment in being of service and doing so in a confidential manner with integrity and professionalism.

Kyle is an enthusiastic, caring and driven business professional committed to educating, and being an advocate for the Merger & Acquisition / Business Brokerage community. He is a proud and active member of the M&A Source and the International Business Brokers Association (IBBA).

Kyle Griffith is a Certified M&A Professional (CM&AP) and is one of more than three hundred M&A intermediaries and professionals with the designation. Kyle has also been awarded the Certified Business Intermediary (CBI) designation by the International Business Brokers Association (IBBA). This designation is held by fewer than 600 individuals worldwide and less than 10 in New York State. The CBI designation is granted to IBBA members who have met rigorous requirements in education, industry knowledge and experience, ethical standards and continuing education. As a CBI, Kyle is well equipped to handle the complexities of acquiring and selling privately held companies.



**Christine Malafi** chairs the Corporate department at Campolo, Middleton & McCormick, LLP, which was recently recognized by Forbes as a Top Trusted Corporate Law Firm in America. Her practice focuses on mergers and acquisitions, corporate governance, routine and complex transactions, labor and employment issues (including sexual harassment prevention policies and training), and other business matters, as well as municipal, insurance coverage, and fraud issues. She routinely represents buyers and sellers in multimillion dollar transactions (from technology companies to manufacturers to healthcare businesses) and serves in a general counsel role for many of the firm's internationally-based clients.

# Maximizing Value In Your Business

By

Ken Pischel

Dynamic Business Consultants, LLC

Your

Fractional CFO & Bookkeeping Specialists



# BUSINESS VALUE MAXIMIZERS

- Sales
- Type of Sales
- Maturation of Industry
- EBITDA
- Assets
- Types of Assets
- Liabilities
- Types of Liabilities
- Business Equity
- Minimizing Risk Factors
- Operational Expertise
- Human Capital

# SALES CONSIDERATIONS

- Recurring Revenue
  - Project Revenue
  - Contract Revenue
  - Customer Concentration
  - B to B Sales
  - B to C Sales
  - Projected Market Growth or Decline of Product or Service
- 



# EBITDA

Earnings before income tax, depreciation, & amortization

## Key Drivers To EBITDA

- Sales
- Gross Margins
- Office Overhead

# ASSETS

=

# LIABILITIES

+

# EQUITY

- Cash
- Accounts Receivable
- Equipment
- Real Estate
- Intellectual Property

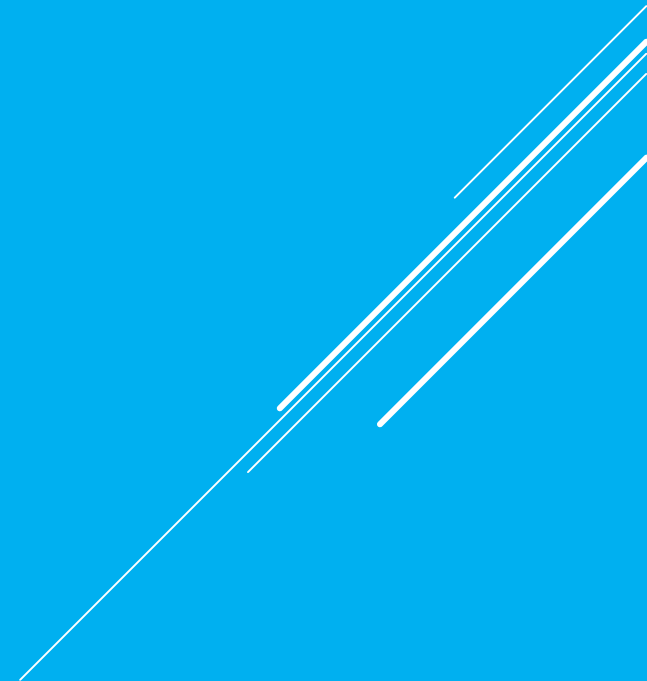
- Accounts Payable
- Debt
  - Credit Cards
  - Loans
  - Leases
  - Lines of Credit
- Payroll Taxes
- 401K Liabilities

- Retained Earnings
- Distributions

**CLEAN RECORD KEEPING IS THAT TRAILS IS ESSENTIAL**


# WHERE IS MY RISK?

- Human Resources
- Contracts
- Insurances
- Accounts Receivable
- Accounts Payable



# OPERATIONAL EXPERTISE

## Scalable Systems That Are Efficient & Secure

- Secure technologies that improve the speed of output and increase labor capacities
    - Project Management Software
    - Production Software
    - Convergence of all key technologies
  - Consistent workflow process' that produce consistent results
  - Expertise in:
    - Project Management
    - Production
    - Logistics
    - Distribution Channels
  - Maintaining the data to verify operational efficiencies is crucial
- 

# HUMAN CAPITAL

**Good People Are Needed To Maintain Technologies & Workflow Process'**

- Key personnel & management:
    - Sales
    - Operations
    - Finance
- 
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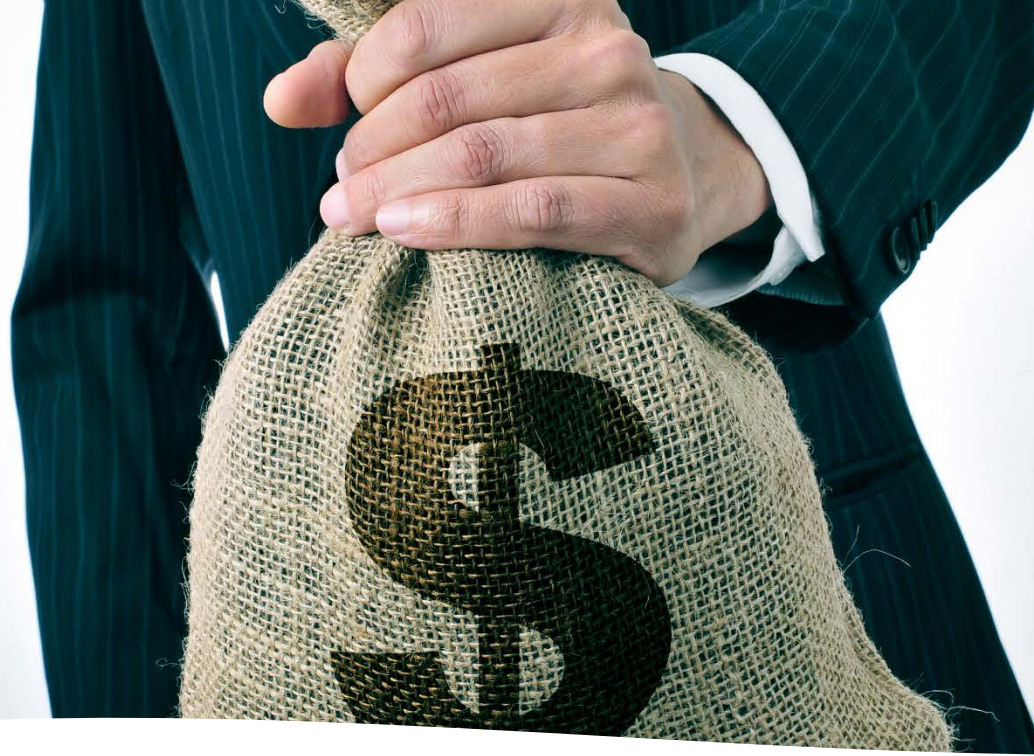
# FAILURE TO MAXIMIZE VALUE

## Can Lead Too:

- Lower Purchase Prices
  - Less Cash Upfront
  - More Deal Contingencies
  - Possible Asset Sale Instead of Entity Sale
  - More Personal Risk In Deal Covenants
- 
- A series of four parallel white diagonal lines extending from the bottom right towards the top right of the slide.

# VALUE MAXIMIZER SUMMARY

- Revenue Consistencies
  - Maximize EBITDA
  - Build Assets
  - Minimize Liabilities
  - Build Equity
  - Smart Contracts
  - Smart Culture
  - Keep Compliant
  - No Short Cuts
  - Efficient Operations
  - Quality People
- 
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# HOW TO BUILD A “SELLABLE” COMPANY

- THE MARKETPLACE & WHAT TO EXPECT
- BUSINESS VALUE DRIVERS



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# WHO WE ARE

SELL SIDE ADVISORY | BUY SIDE ADVISORY | BUSINESS VALUATION  
EXIT PLANNING | BUSINESS CONSULTING | COMMERCIAL REAL ESTATE

The NYBB Group is a full-service, boutique merger and acquisition firm dedicated to serving the lower middle market with integrity, professionalism, and confidentiality. We work closely with business owners, financial sponsors such as private equity groups, and individual investors on business transactions with enterprise values of \$1 million to \$50 million.



*leading the way since 2003....* **The NYBB Group**

# Kyle Griffith, CBI, CM&AP

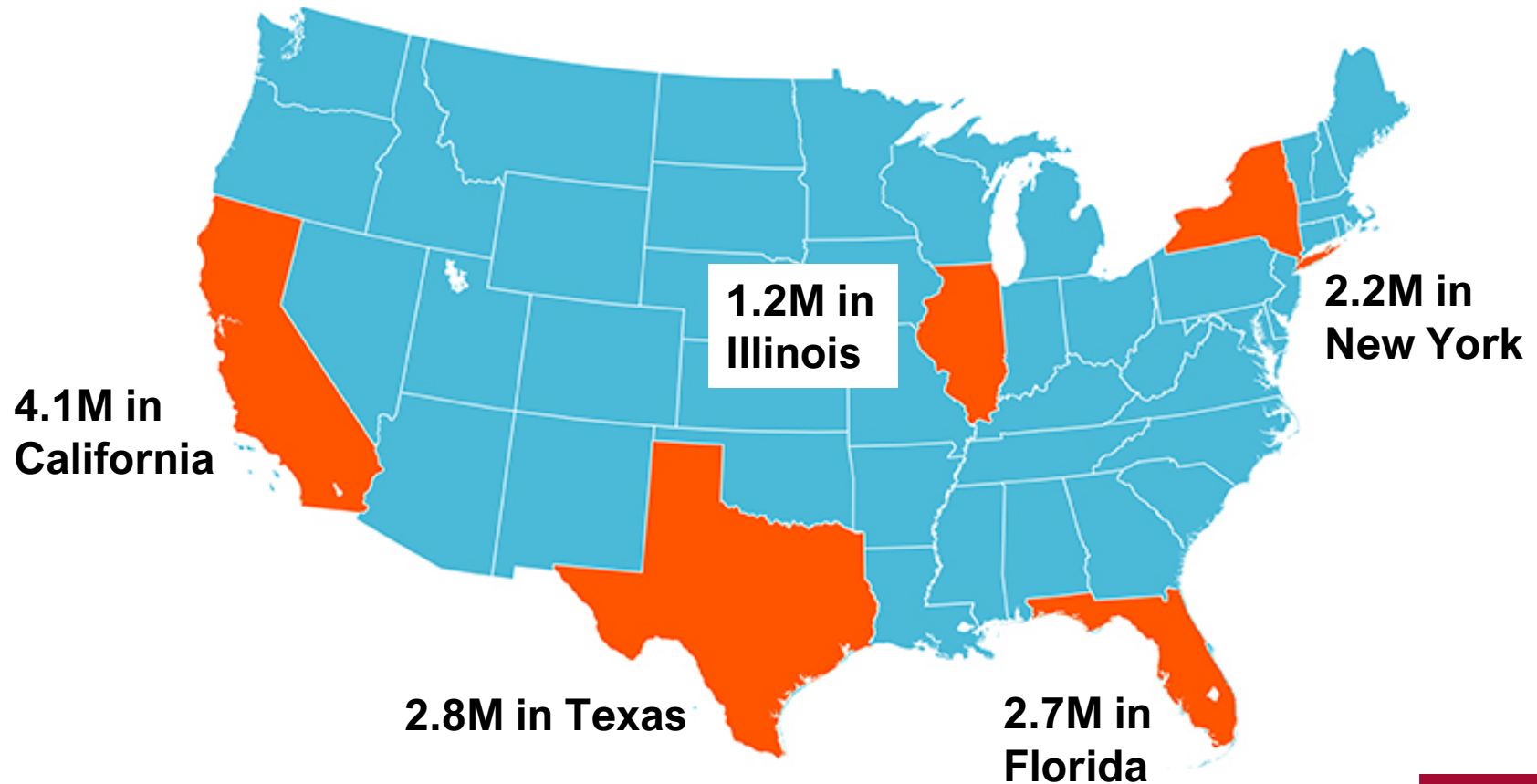
## Managing Partner of The NYBB Group

- Managing Partner of The NYBB Group
- CEO and Found of Emina Network
- 11+ Years of experience representing privately held companies in need of Merger & Acquisition and Business Advisory Services.
- Over 15 years of experience operating several businesses including a family-owned printing and shipping company
- Certified Business Intermediary (CBI)
- Certified Merger & Acquisition Professional (CM&AP)
- Board of Governors of the International Business Brokers Association (IBBA) & the International Association of Business Intermediaries (IABI)
- Board Member of the New York Association of Business Brokers



*leading the way since 2003....* **The NYBB Group**

# 31.7 Million SMALL BUSINESSES IN THE UNITED STATES



*leading the way since 2003....* **The NYBB Group**

# Why the Market is Robust

## #1 Fear .... TAXES

“One of the chief concerns right now is that the Biden administration will follow through on campaign plans and increase capital gains taxes.

The Biden plan would effectively double the capital gains rate for businesses valued at more than a million dollars,”

said Scott Bushkie, Chairman of the Board-The M&A Source





- **M&A is Accelerating**
- **Companies Have Accumulated 7.6 T  
In Cash And Marketable Securities  
to invest**



# THREE KEY FACTORS .... A TRIFECTA

**Low Interest  
Rates**



**Vaccine Demand  
and Availability**

## **CONSUMER CONFIDENCE**

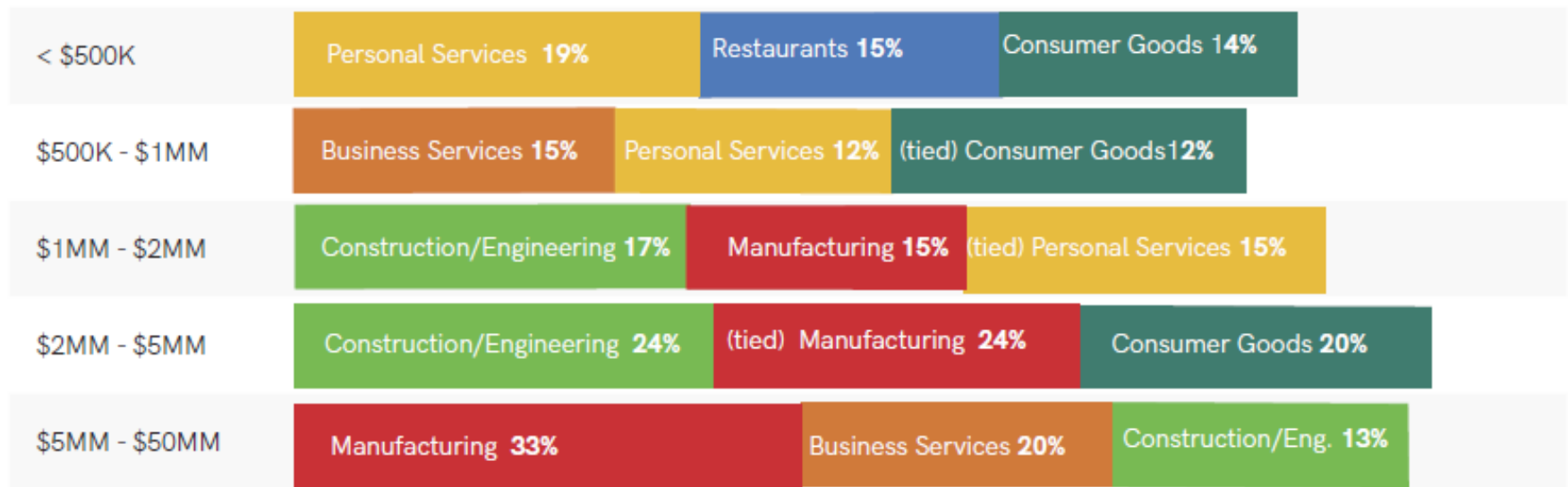
- *FOR COMPANIES IN DISTRESS CONSOLIDATIONS ARE NECESSARY*
- *FOR OTHERS DEALMAKING WILL FILL GAPS IN SKILLS, RESOURCES AND TECHNOLOGIES*



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# What are they Buying?

FIGURE 11: TOP 3 INDUSTRIES BY MARKET SECTOR

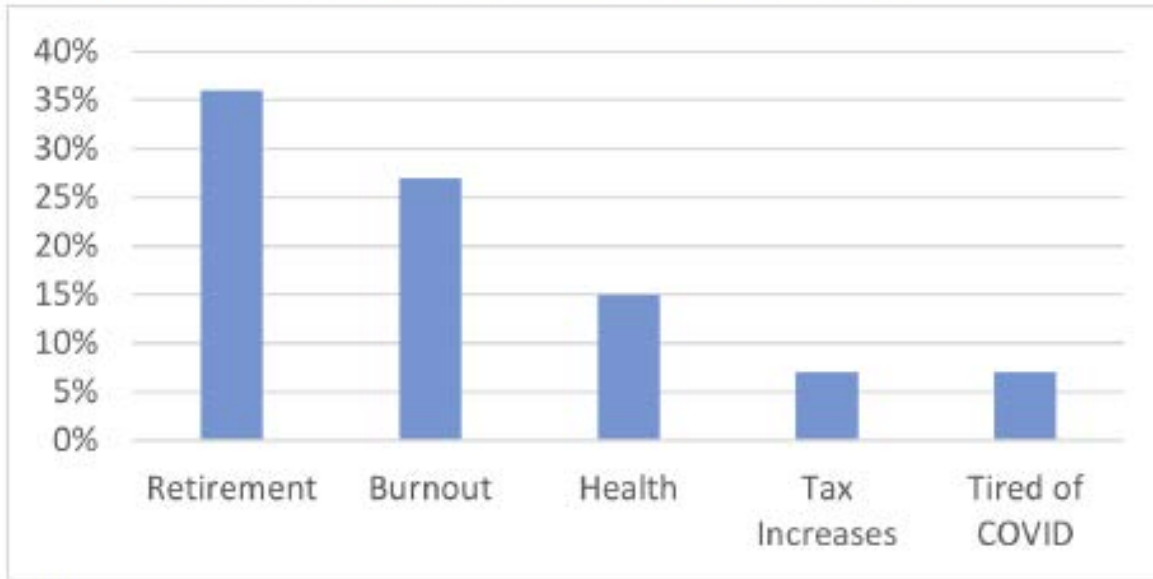


# Reasons Sellers are going to Market in 2021

While retirement still leads as the number one reason sellers go to market, burnout jumped as a leading reason 27% of sellers went to market. The number of sellers citing health issues (15%) is also higher than previous surveys, suggesting the pandemic has taken a heavy toll on business owners.

In addition, 7% of sellers went to market to get ahead of potential increases in capital gains tax. The Biden administration has indicated it will ask for significant increases in the capital gains tax rate in the near future.

FIGURE 2: TOP REASONS BUSINESS OWNERS DECIDED TO GO TO MARKET IN 2021



\*Respondents were able to choose more than one motivating factor.

*"If Biden's tax plans come to fruition, the capital gains tax rate could effectively double, from 20% to 39.6% for income exceeding \$1 million. Right now, that means business owners need to shift their focus from maximizing total transaction price to maximizing after-tax proceeds," said Scott Bushkie, President of Cornerstone Business Services.*

*"Even if a business owner is projecting 5% annual growth, they'd have to run their business another five years just to net out the same amount they could today after increased capital gains," Bushkie continued.*

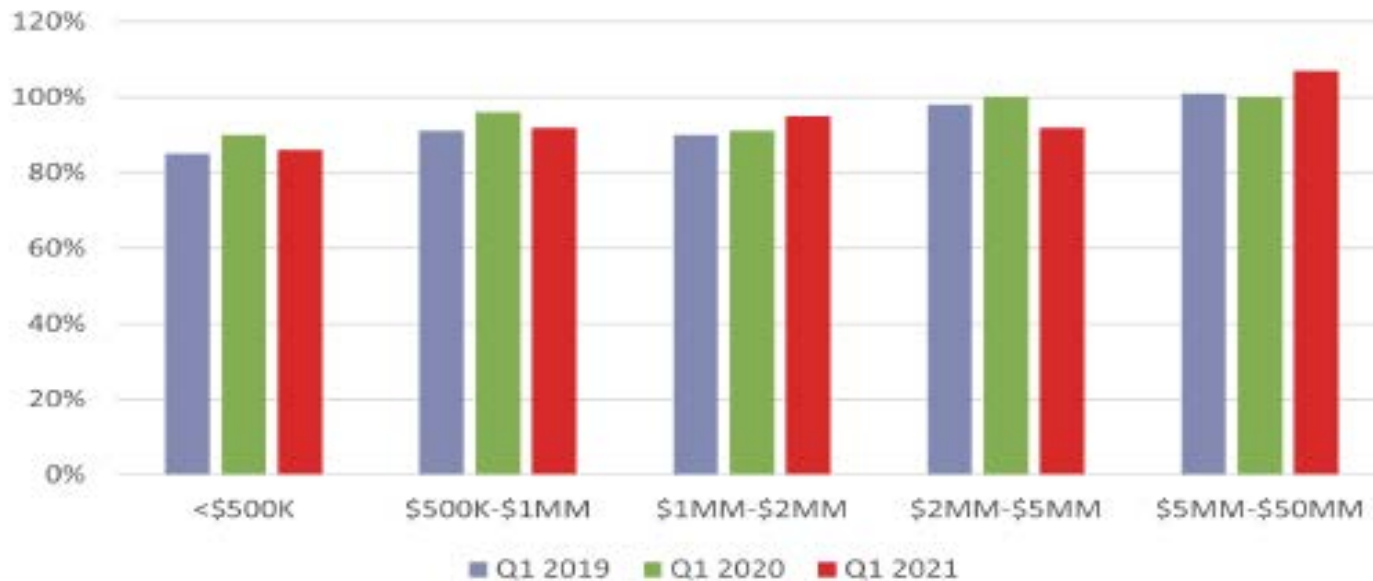


# State of the Market

## Market Confidence Rebounding

The latest data from the Market Pulse survey reflects the growing premiums business owners receive as the size of their company increases. Multiples increase consistently as businesses get larger. And these businesses are more likely to draw buyer interest from the widest geographic radius.

In fact, sellers in the \$5 million to \$50 million sector realized, on average, a final sale price that was 107% of benchmark. Overall, across all sectors, businesses are received 91% of benchmark in Q1 2021.



*M&A Source Market Pulse Survey 1<sup>st</sup> Q 2021*

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# Multiples for Purchase Price of Q1 2021 Business

Multiples climbed in the lower middle market this quarter, while still remaining below market peaks. Historically, multiples in Main Street have varied within about a 10% range.

	2021 Q1	2020 Q1	2019 Q1	2018 Q1	2017 Q1	2016 Q1	2015 Q1	2014 Q1
Median Multiple Paid in Main Street Business Sales (SDE)								
<\$500K	2	2	2	2	2.3	2	2	2
\$500K - \$1MM	2.8	2.6	2.5	2.8	2.8	2.8	2.7	2.6
\$1MM - \$2MM	3	3	3	3.3	3.3	3	3.3	3.1
Median Multiple Paid in Lower M&A Transactions (EBITDA)								
\$2MM - \$5MM	4	3.3	4.3	4.4	5.3	4	4.5	4.3
\$5MM - \$50MM	5	4.3	6	6.1	5.3	5.5	4.9	4.5

# Financing Deals 2020

Year-over-year trends for cash at close and seller financing are relatively consistent. Earnouts typically accounts for 2% or less of deal financing.

“We think earnouts will increase if burnout drives more sellers to market,” said Kyle Griffith of The NYBB Group. “Sellers whose businesses were affected by COVID-19 may not realize what would have been their full 2019 valuation at the closing table today, but earnouts can be structured to make them whole in one to three years.”

FIGURE 8: SELLER FINANCING CONSISTENT WITH 2020

	Q1 2021		
	Cash at Close*	Seller Financing	Earn Out
<\$500K	84%	13%	2%
\$500K-\$1MM	83%	10%	2%
\$1-\$2MM	83%	11%	4%
\$2-\$5MM	85%	8%	-
\$5-\$50MM	87%	7%	2%

\* Cash at close reflects a combination of buyer's equity and senior debt.

	Q1 2020		
	Cash at Close*	Seller Financing	Earn Out
<\$500K	86%	12%	1%
\$500K-\$1MM	80%	13%	2%
\$1-\$2MM	77%	13%	2%
\$2-\$5MM	78%	17%	1%
\$5-\$50MM	84%	8%	2%

M&A Source Market Pulse Survey 1<sup>st</sup> Q 2021



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# Forbes

1. Lots of capital
2. High lending multiples (3.4x EBITDA for I MM and higher for MM)
3. Buyers willing to over-equitize transactions = higher value
4. Strategic acquirers are thirsty and moving down market
5. ½ Global buyouts are “add ons” to exiting platforms
6. Buy and build strategy very popular for value creation
  - a. Buyers purchasing smaller and smaller businesses and merging them together



# WE ARE IN A PERIOD OF HIGH ASSET VALUES

- **Search For Technology**
- **Biggest Challenge Is Valuation**
- **Large Deal Volume Is Up 2% But Valuations Were Up 18%**

VALUE



# OTHER FACTORS

- A. Low quality deals getting high values**
- B. ....If there is a downturn high quality assets will survive others will struggle**
- C. Owners loving the boom ... want to exit because of looming tax increases**
- D. Buyers have a tough time remaining disciplined for valuation**
- E. Analysts don't see a slowdown**





# JUST THE FACTS

- 30% of Businesses have 2<sup>nd</sup> Generation Transfer
- 12% of Businesses have 3<sup>rd</sup> Generation Transfer
- 49% of all Owners have done no Exit or other planning
- 50% of Businesses experience the end of business due to one of the 5 D's-Death, Disability, Divorce, Distress, Disagreement
- 80% of Value is in Intangible Assets
- 93% of Owners have no after business life plans



# Why Do Deals Fail...

- **\*Undervalue the company**
- **\*Unable to control the exit**
- **\*Pay too much in taxes**
- **\*Fail to achieve the owner's personal goals**





# What makes a business more attractive

## **RELIANCE**

One business appears to rely on the Directors and Owners and the other appears to rely on staff members.

## **NEWSTART**

One may be a new start company and the other may be an established company with a 5-year trading history.

## **R&D**

One of the companies may have spent a considerable amount on Research and Development that will lift their profits in the future.

## **SALES CONTRACTS**

One may have developed long term contracts that will ensure the profit for the next 24 months whereas the other will have to rely on winning contracts or work on a weekly basis.

## **CUSTOMER LOYALTY**

One may have an easily identifiable customer database that is very loyal and the other may have a high turnover database.



# What makes a Business More Attractive

## **GROWTH MARKET**

One of the companies may have developed a product that is positioned in a growth market and the other may not.

## **GEOGRAPHY**

One may be in a better geographical segment.

## **BRAND**

One may have a brand that is more recognizable.

## **PATENT**

One of the companies may have developed a worldwide patent that locks the brand into immediate worldwide distribution.

## **DOMINANT NICHE**

One of the companies may be a dominant player in a niche whereas the other is a smaller player with a less of a competitive advantage in a wider marketplace.

## **STRATEGIC FIT**

One business may be a strategic fit to the other business and therefore the acquiring business may be able to generate more profit in the future as a result of this strategic fit.



# Grow Your Business while Keeping the “End in Mind” It all starts with a Good Exit Strategy!



## Benefits of an Exit Strategy

- Peace of mind
- Provides strategic direction
- Creates a smooth management transition
- Generates income for retirement / disability
- Minimizes tax impact
- Protects and enhances business value



# Business Value Drivers

- Positive Earnings EBITDA/Net Cash Flow
- Clean Financial Statements/Corp Returns/ Minimal Add Backs
- Professional Management Team place with Highly Trained Staff
- Written Policies and Procedures for every aspect of the Business
- Minimize Risk- Lawsuits, Customer Loss, Outdated Technology, Labor Issues, Tax Situations, Industry Changes, Competition, Vendor Relationships
- Defensible Market Positioning with Dominant Market Share
- Products or services that provide recurring revenue
- Product Differentiations
- Low concentration of customers
- Technology/Proprietary Processes
- Scalability



# Main Factors Affecting The Value of Your Company

## EXTERNAL FACTORS

- Economic Conditions
- Socioeconomic Conditions
  - Baby Boomer Effect
  - Affordability-i.e. The local economy
- New Business Competition
- Government Laws Tax Policy
- Competition
  - Local/Regional/National/Overseas

## INTERNAL FACTORS

- Management Key Personnel/Talent
- Services or Products Diversity/Specialty
- Systemization (Internal systems)
  - Inventory-Control
  - Systems/Perpetual/Physical
- Owner Control Personal Involvement
- Contracts Employees and Customers
- Client/Customer Base



# Determining the Value of Your Business

DO YOU KNOW  
WHAT YOUR  
BUSINESS  
IS WORTH



## Get a Professional Valuation

- Gain knowledge of your **Targeted Selling Price**.
- Assess whether to **sell** now or hold and grow the business.
- Gain significant insights about **value drivers**.
- Learn about **risk factors** specific to your business.
- Review **First Research** and **BIS** reports.

Avoid getting a valuation from any person or firm that does not have one the following professional designations: CVA, ASA, CBA, ABV, BVAL, AVA  
Where high ethical standards and ongoing training and recertifications are required



# Determining the Value of Your Business

Recasting the  
Profit & Loss  
Statement



The Balance  
Sheet – Recast  
Clean Up

Profitability  
Your Company  
vs.  
The Industry

Valuation-  
Historical &  
Future

Forecasting  
the Future



# REAL-LIFE EXAMPLES

## A. HVAC/Refrigeration Service Company bought by Private Equity

1. Roll Up
2. Owners to run company
3. Equity buy in
4. Platform to be sold in 18-24 months
5. Weak Financials-Many addbacks
6. \$2.3M Ebitda
7. \$12.8M Sale Price(Extra Turn received), 10% Escrow, 10% Equity, Cash



## B. Engineering Company

1. On the market 45 Days
2. 82 Inquiries
3. 4 LOI-All at approximately 4.5x-5x multiple
4. Independent Sponsors
5. Strategic Acquirers
6. \$4.5M Avg. 3yr. EBITDA *(weak 2020 due to COVID)*
7. Valuation at \$22.5M



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# Thank You!

From The NYBB Group



Questions?



[kyle@thenybbgroup.com](mailto:kyle@thenybbgroup.com)

516-346-526

Ken

631



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# ISSUES TO BE ADDRESSED WHEN SELLING OR PURCHASING A BUSINESS

Presented by Christine Malafi, Esq.



CAMPOLO, MIDDLETON  
& MCCORMICK, LLP  
A PREMIER LAW FIRM



# PREPARING FOR THE SALE OF YOUR BUSINESS

## Get a professional business valuation.

This will give you a realistic idea of what your business is worth from an objective, outside source, a basis for gauging buyer offers, and an idea of what you can expect to net from the sale.

It will also tell you your business's market position, financial situation, strengths, and weaknesses (which you can hopefully correct prior to putting it on the market).

# PREPARING FOR THE SALE OF YOUR BUSINESS

## Get your books in order.

Buyers evaluating your business generally require at least three years' worth of financial information.

The more formal your statements (account-reviewed or prepared vs. internally generated statements), the better the impression you'll make and the easier the due diligence for a buyer.

Tax returns may suffice.

# PREPARING FOR THE SALE OF YOUR BUSINESS

## Understand the true profitability of your business.

Make sure you have supporting documentation for the variety of nonoperational expenses your business claims.

E.g., your business may be paying for your personal automobile lease.

Check for infrequent expenses incurred during the past three years that should be excluded in a buyer's analysis of recurring cash flow.

E.g., moving expenses from a move to a larger facility or unusual legal expenses.

# PREPARING FOR THE SALE OF YOUR BUSINESS

## Consult your financial advisor.

Understanding your personal and corporate tax situation may also help you recognize your options with regard to deal structure.

## Get ready to make a good first impression.

Will a buyer visiting your shop for the first time see order or chaos?

Buyers look for companies that show well, as an orderly shop is often indicative of an orderly management team and back-room operations.

# PREPARING FOR THE SALE OF YOUR BUSINESS

## Organize your legal paperwork.

Review your incorporation papers, permits, licensing agreements, leases, customer and vendor contracts, etc. Make sure all are readily available, current, and in order and pay special attention to:

**a. Ownership Agreements.** It is not uncommon for shareholder or operating agreements and the related agreements to have never been signed by any or some of the owners. The “corporate house” should be in order and you should fix any issues with missing votes or resolutions may have been required over the years, but not obtained. No potential buyer wants to get in the middle of a dispute between owners over their rights and interests at the time of a sale.

# PREPARING FOR THE SALE OF YOUR BUSINESS

**b. Employment Agreements with Key Employees.** Key employees include management and sales people, but, depending upon the type of company, may be expanded *e.g.*, for a software company, it would include the most important developers.

Critical provisions include the non-compete and other restrictive covenants, such as non-solicit of customers, partners, suppliers, and other employees.

Also review to determine whether independent contractors truly meet federal and state criteria for such a position regardless of what the contract says.

If there have been any verbal promises about such things as stock or severance, it is essential that they be reduced to a signed writing as well.



# PREPARING FOR THE SALE OF YOUR BUSINESS

**c. Customer and Partner Agreements.** Make sure that contracts are in place with significant customers and partners, and that rights, obligations, and whether the contracts can be assigned are spelled out.

**d. Supplier Agreements.** Determine whether a buyer can terminate a supplier agreement (or another agreement) post-transaction.

Understanding which terms would be important ahead of time and working towards putting the appropriate language in place ahead of time can be a valuable exercise.

# PREPARING FOR THE SALE OF YOUR BUSINESS

**e. Ownership of Intellectual Property.** Even if a company has not been granted any formal patents or trademarks, buyers will want to know that the intellectual property ownership is solid and that all employees, independent contractors, and suppliers have previously made the appropriate assignments sufficient to preclude a future adverse claim.

# PREPARING FOR THE SALE OF YOUR BUSINESS

## Consider management succession.

If you're absolutely vital to your business, who will a buyer be able to turn to for help running the business after you leave?

You should have a succession plan in place before going to market or be prepare to work with buyer for a period of time.

# TYPES OF TAXES LEVIED DEPEND ON THE TYPE OF BUSINESS BEING SOLD

## Sole Proprietorship –

- A sale is treated as if each asset is sold separately
- Most assets trigger capital gains taxes

## Partnership –

- Sale of a partnership interest is treated as an asset transaction, with capital gains, subject to certain exceptions (unrealized receivables or inventory items is subject to ordinary income tax for partners)

# TYPES OF TAXES LEVIED DEPEND ON THE TYPE OF BUSINESS BEING SOLD

## C Corporations –

- C corporations and their shareholders usually face double taxation upon an asset sale followed by a liquidation
- **Stock sale** proceeds are taxed at the capital gains rate (single taxation)
- **Asset sale** proceeds are taxed at ordinary corporate income rates (double taxation) and then levied on shareholders upon distribution

# TYPES OF TAXES LEVIED DEPEND ON THE TYPE OF BUSINESS BEING SOLD

## S corporations –

- S Corporations are not subject to double taxation – only owner is taxed on gains (LLCs treated similarly)
- Gains realized upon the sale of an S Corporation are not subject to an additional 3.8% Medicare tax that C Corporations are subject to when they are sold (this assumes the S Corporation is an active trade or business)

# TYPES OF TAXES LEVIED DEPEND ON THE TYPE OF BUSINESS BEING SOLD

## S corporations –

- **A stock sale** is treated as a straight sale of stock, but the U.S. Tax Code allows buyers and sellers of the stock of an S corporation to make a section 338(h)(10) election so that a qualified stock purchase will be treated as an asset purchase for federal income tax purposes.
- A straight stock sale would yield long or short-term capital gain or loss to the seller and the buyer's basis in the stock would be the purchase price.
- In a straight stock sale, the buyer would not be permitted depreciation or amortization deductions.

# TYPES OF TAXES LEVIED DEPEND ON THE TYPE OF BUSINESS BEING SOLD

## S corporations (continued) –

- If a 338(h)(10) election is made, and the shareholder sells stock to the buyer, he pays taxes as if he sold the company's assets (may be greater taxes, so negotiate a true up in favor of seller)
- Since the company itself does not pay taxes on the sale of its assets, the income from the sale of its assets passes through to the shareholder who is responsible for paying taxes



# TYPES OF TAXES LEVIED DEPEND ON THE TYPE OF BUSINESS BEING SOLD

## S corporations (continued) –

- **Asset sale** taxes are calculated individually for each asset
- If the company that sells the assets is an “S” corporation that was a “C” corporation within the last 5 years, the “S” corporation’s asset sale could trigger corporate-level taxes

# REDUCTION OF BUYER'S FUTURE TAX LIABILITY

- Buyers should discuss with tax advisers the effects of:
    - (i) a step-up in tax basis (allows for the basis of the asset purchase to be adjusted to its cost upon a taxable purchase)
    - (ii) asset depreciation
- to reduce a buyer's future tax liability

# REDUCTION OF SELLER'S NET TAX LIABILITY

- If the seller has net operating losses (NOLs) or capital loss carry overs, gains from an asset sale might be offset, resulting in reduced income tax at the corporate or individual level
- In a stock sale, the NOL could transfer to the buyer for buyer's future use of such NOL (will most likely be limited)

# DEFERRING THE PURCHASE PRICE

- If payments are deferred, seller may recognize taxable gains only as the buyer makes payments.
- The seller pays the tax as gain is realized at the current tax rate, so seller has risk that rate may increase.
- If the transaction is structured as an installment sale, a seller will pay taxes long term for capital assets sold (only available under certain circumstances, i.e. seller must receive at least one payment for the business after the year of the sale)

# CONSIDERATIONS

## If cash –

- The gain is subject to income tax, regardless of the type of sale (i.e., sale of assets/sale of stock)

## If equity in the business –

- Stock exchange between the seller and the buyer may be considered a “corporate re-organization”
- The equity component may be tax free or tax deferred
- Speak with a tax adviser about how to structure the transaction to ensure that the seller can take advantage of these benefits

# SALES TAX

- It is possible that sales tax exposure could transfer from seller to buyer regardless of the transaction form (*Wayfair* decision expanded retailers' responsibilities to collect sales taxes on out-of-state purchase with no physical presence required (Economic Nexus))
- Key issues to consider during a due diligence review with *Wayfair* include selling company's sales tax liabilities may attach to the assets and succeed to the buyer and identifying activities that can create a nexus

# PRE-TRANSACTION ESTATE PLANNING FOR THE SELLER

There may be opportunities to transfer corporate stock out of your estate via gift prior to an asset or stock sale.

Seller may use an Intentionally Defective Grantor Trust (IDGT)

- The grantor establishes a trust and funds the trust with cash which purchases the asset from the grantor with a mix of cash and a promissory note
- Upon sale of the business, the trust would have the liquidity to pay the grantor back with the remainder to be invested for the benefit of the beneficiaries
- The sale with the trust will not trigger capital gains tax because the income of the trust is taxable to the grantor
- For tax purposes, the grantor is transacting with himself



# THANK YOU

**Christine Malafi, Esq.**

Senior Partner

Campolo, Middleton & McCormick, LLP

**Contact Christine:**

(631) 738-9100

[cmalafi@cmmllp.com](mailto:cmalafi@cmmllp.com)



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**& MCCORMICK, LLP**  
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