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Considering selling your business?

Without doubt, selling your business can be a challenging and emotional process for all involved. Careful preparation is necessary to achieve the best possible outcome, from both an after-tax value perspective and a smooth process perspective. While the outcome of any sale process is ultimately impossible to foresee, you can significantly increase the likelihood of closing a deal on acceptable terms if you carefully plan ahead from both a business and tax point of view.

Business and tax factors are equally important to helping shareholders achieve their objectives when they decide to exit their business, and both should be considered well before a sale takes place. Let's review some key considerations you should be aware of, preferably in advance of deciding to sell your business.

Business considerations

Management succession plan

If you're actively involved in the day-to-day operations of the business, now is the time to think about who will run the business after you sell. Do you still want to be involved in the business? Is the next generation incorporated in the current structure? Is there a strong management team in place already?

If you've essentially made yourself redundant to the general day-to-day operations of the business, that will be an attractive selling point to potential buyers, assuming you've got a strong management team in place. If you're still involved with the operation of the business but have identified a leadership transition process, you should take action to ensure that you don't represent most of the business's goodwill. Not having a proper transition plan in place can eliminate certain financial buyers, including private equity firms. It can also reduce the value of the business, lead to contingent consideration (earnouts), or result in your longer continued employment with the business or your retaining a larger ownership interest after closing. Putting a transition plan in place is also a form of insurance to allow for business continuity in the event of an unforeseen tragedy.

Strong financial reporting

When selling your business, it's critical to have solid financial information since management reporting is one of the main tools the buyer will use to assess the value of the business. The financial information needs to be accurate and consistent; it helps a buyer to understand what makes your business tick and where opportunities for improvement lie. When there's uncertainty, buyers may want to discount the price they're willing to pay for the business or adjust the terms of the deal structure in their favour.

Having the right internal and external financial resources is critical. Potential buyers will examine how you're managing finance operations. They'll want to know whether you're using a part-time or full-time bookkeeper, controller, VP of Finance or CFO. They're also going to assess who is carrying out external reporting on the financial statements,

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and whether through a notice to reader, review or audit engagement.

In addition to looking at *who* is managing your finances, potential buyers will also consider *how* that financial information is being presented. Some of the critical questions buyers will ask include:

- How many adjustments are being made at year-end (compared with month-end)?
- Are the right systems in place to support the reporting function?
- What kind of monthly reports are available?
- What kind of financial information is being tracked? Customer, supplier, product line, revenues, margins, contribution?
- How accessible is the information?

When you present reliable and real-time financial information, and can demonstrate that this information is being used to manage the business, buyers will gain confidence in the picture of the business and earnings that is being presented. This in turn makes the due diligence process easier to manage and reduces the potential for business valuation discounts due to uncertainty. Of course, if you have better-quality information available, you should also see tangible benefits in managing your business during your period of ownership.

Organization is key

When you're preparing to sell your business, it's important to ensure your records are organized and easily accessible. Potential buyers are interested in businesses that have processes in place for document retention, employee records, customer contracts, supplier contracts, leases, risk management and regulatory matters. When information is complete and presented in an organized manner, it provides confidence to the buyer, minimizing concerns around any "unknowns" and maintaining deal momentum. If you're in a position where formal contracts don't exist, now is the time to start getting those relationships properly documented; you'll want to have the information readily available on request when going through the due diligence process.

Some reports can be compiled quickly on an ad hoc basis, but having proper processes in place — years before a sale — can reduce the stress and time it takes to prepare for due diligence. It also provides the added benefit of helping the current business run more smoothly and with less risk while you're still the owner.

Optimizing your tax outcomes

Get your tax structure right

On the tax side, achieving the best outcome takes advance planning. You'll want to ensure that you have an optimal tax structure that provides the greatest after-tax proceeds for your selling shareholders. For example, you should consider whether a reorganization of the corporate group is needed to ensure that the greatest tax saving and deferral opportunities are available to you on the exit.

One example of such a structure involves having the future growth of the operating company shares accrue to a family trust so that you and your extended family can access the lifetime capital gains exemption (LCGE) on the sale of the company's shares. To qualify for the LCGE, the shares must be qualified small business corporation (QSBC) shares. The QSBC share rules are quite complex but generally require the shares to have been held for at least two years and for the company, directly or through a connected corporation, to be using 90% or more of the fair market value of its assets in a business primarily carried on in Canada.

The LCGE is almost $850,000 per person, which may represent a significant portion of the value if multiple exemptions are available on the sale. However, you can only pass future growth to the trust or to other family members. This means that waiting until just before the sale to put this structure in place will not be beneficial. There would be little time available for the company to grow sufficiently in value between the date of the reorganization and the closing of the sale. Generally, the trust must hold the shares for two years in order for the LCGE to be available on the sale of the shares by the trust.

If your business has too much of its current value represented by assets that aren't used in operating the business in Canada (such as passive assets or shares of foreign subsidiaries), the LCGE may not be available. There may be a need to "purify" the company so the shares qualify for the LCGE, and depending on the proportion of these "bad" assets, it may be necessary to purify more than two years before a sale.

The LCGE is available only on the sale of shares. Some transactions are structured as "asset deals" where the corporation that carries on the business sells its tangible and intangible assets to the buyer. Some buyers may prefer this structure since they would not inherit the tax history of the corporation that carried on the business and, because they are buying the assets directly, they can depreciate the actual fair market value of the purchased assets for tax purposes. This perceived tension on deal structure between buyers and sellers can often be overcome by prudent tax planning and negotiation.

The tax bridge

Taxes can be a bridge. Creative tax planning can help you bridge your needs with those of the buyer. The top-line price you'll receive when you sell your business is far less important than what you keep in your pockets after taxes have been paid. If the structure that is used for the sale can also provide tax benefits for the buyer, such as in the case of an asset deal, the buyer may be willing to increase the purchase price to share some of this benefit with you. Even if the buyer does not wish to change the price, perhaps the buyer's tax benefit will help with other deal negotiations and help bridge other gaps in the process.

Choose the right advisors

Having experienced M&A advisors working with you as early in the process as possible can help you achieve the best financial outcome. Strategic and financial buyers often come to the table prepared with advisors who are looking out for their best interests. It's important that you be equally prepared so that you can achieve the best financial and structural outcome.

For many, selling a business is a once-in-a-lifetime transaction. You'll want to surround yourself with a trusted team of business and legal advisors who understand your intentions and will work with you to achieve your goals. Success can mean different things to different people. Whatever that means to you — whether it's optimizing pre- and after-tax proceeds, preparing for retirement or continuing your interest in the business — having the right people behind you can help you sell your business on your terms.

Learn more

For more information on this and any other topics that may be of concern, please contact your EY or EY Law advisor or one of the following professionals:

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