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Tax Considerations for Buying or Selling a Dealership

Considerations for an Outright Sale

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In the third and final installment of our series on Tax Considerations for Buying or Selling a Dealership, we will focus on the seller. The basics are the same whether you are selling to a current employee, a family member or a white knight coming to save the day. We will first address the tax considerations and then expand to more general considerations.

Regardless how you choose to sell your dealership, the biggest obstacle to overcome is the mental challenge you will be facing. As the Chief, the Big Cheese, the Top Dog, or the Queen Bee, you will now be sharing the spotlight or fading into the sunset. A successful sale requires that you start preparing now for this change.

There are two ways to sell your store. You can sell over time or sell it all now. Selling over time presents its own particular situations, a subject which we plan to address in the near future. In this article, we will focus on the outright sale. Below are 9 considerations that should be top of mind in an outright sale of your dealership.

1. Focus on net, after tax dollars. Oftentimes, sellers spend too much time focused on the structure or sale price and end up losing money. Focusing on structure, stock sale or asset sale alone may not produce the most money. For example, in a stock sale, the buyer will want to protect themselves and record liabilities for vacation, future chargebacks or future obligations. These liabilities reduce the net worth of the company and reduce your proceeds. Instead, you should focus on the net, after tax dollars, that will be in your pocket.

2. Long-term capital gains are usually better than ordinary income. In most cases having proceeds that generate long-term capital gains (LTCG) is better than having proceeds that generate ordinary income. LTCG can be generated from the sale of stock, the sale of goodwill/blue sky, the sale of personal goodwill or the sale of real estate.

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3. Be mindful of the structure for additional income. Proceeds categorized as consulting fees will subject you not only to ordinary income but also to self-employment taxes. Non-compete fees are not subject to self-employment tax but they are taxable as ordinary income.

4. How you finance the sale dictates how the proceeds will be taxed. If you finance part of the proceeds, the amounts received are taxable when cash is received and are based on the asset sold. If the goodwill is financed, the future proceeds will be LTCGs. If a non-compete is paid over a period of time, the future proceeds are ordinary income.

5. When to liquidate the company in a sale. In many cases the liquidation of the company before the end of the taxable year may yield a significant tax benefit. Depending on your basis in the company, you may be able to offset part of your LTCG. If you acquired ownership through an equity purchase, pay particular attention to this item.

6. Goodwill you acquired can offset taxable income. Do not forget that goodwill you acquired can be used to reduce the gain on the goodwill you sell. Remember, you have amortized your goodwill so there may be a difference between the “book” gain and the taxable gain.

7. Consider terminating your LIFO election. LIFO will be recaptured when you sell your inventory. These recaptured reserves will be taxed as ordinary income. If you are seriously considering selling your store, it may be a good time to terminate your LIFO election and spread the tax on the reserves over a period of years.

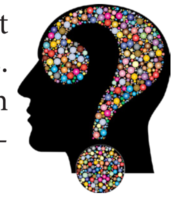
8. Consider when to take trade discounts. Trade Discounts (interest credits, advertising credits and similar factory programs) are used to offset the difference between the flooring amount and the price paid by the buyer. If you have not elected this deferral, you will have a significant deduction when you sell your inventory. But why not take that deduction now?

9. Considerations for real estate. If you own real estate, you need to decide if you want to be a landlord, to exchange for another property or cash out. Exchanging, commonly referred to as a 1031 exchange, offers the possibility of deferring taxable gains to a future sale. Carefully following the requirements for this structure is paramount. Being a landlord has both advantages and disadvantages. Cashing out probably will result in three different tax structures. Part will be long-term capital gains, part will be ordinary income and part will be a hybrid rate. We will save the in-depth discussion on real estate taxation for a future article.

Depending on your individual situation and family structure, there may be other alternatives to be considered that generate ways to reduce income taxes. These are too numerous and individualized to detail in this short newsletter.

Other Items to Consider

Beyond tax considerations, it is important you understand why you are entering this transaction. Deals often fall apart because the seller hasn’t thought through some of these things. Here are some of the most common items we believe a seller should be thinking about.



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- **How will your family feel?** Have you addressed your family members that will not have the opportunity to be owners? Ensure these conversations happen before you progress too far with a buyer.
- **Obtain factory approval.** Before getting too involved in the deal with a potential buyer, do a little investigative work. Can the buyer be approved by the factory? Do they have the financial ability to pay for the purchase? You do not want to spend time and money negotiating with someone who is unable to complete the transaction.
- **Plan for transition expenses and time.** Just because the store has sold, you will need to plan for months of activity to wind-down the company. Receivables need to be collected, vendors need to be paid, final sales and payroll tax returns need to be filed, W-2s will need to be prepared at year end and on and on. It is best that you maintain the DMS computer and hire your controller to handle ongoing activity. Also, it is typical for the sale agreement to have a mutual assistance clause; and thirty to ninety days will not be enough time to liquidate the company.
- **How will employees be transitioned?** How do I protect my key employees? This will be a major transition for many of your employees also. Long-term employees may have a difficult time adapting to a new owner. Is this of concern to you or do you want to pay them a bonus as a thank you and let them be on their own?
- **Adjust your personal living budgets.** Prepare for an increase in your monthly living costs. Gas, car insurance, health insurance and such will no longer be provided by the dealership. Acquaint yourself with titling and registration requirements. Most of you will be surprised with the requirements to renew your car tags.
- **Plan for your new normal.** What are your hobbies? You will need something to occupy your time. So many people you encounter on a daily basis who are considered friends will no longer be part of your daily routine. You will lose contact with many and your circle of influence will shrink.

When entering into your sale, try to treat this as just another negotiation. Everything is on the table and you need to look for ways to make this as simple and easy as possible for you.

Selling your store will be a major life change. Knowing why you are entering this process is key to a smoother transition. Making preparations before the closing date will also aid in a smoother transition for you and your family. We hope this article series will provoke thoughts and questions as you begin the process of acquiring a dealership. Our professionals are available to assist you. Please contact our office for more information.

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