



So... You've Decided to Sell

By Sean M. Wonder & Rebecca Stoedter

Some time ago, we co-authored an article that appeared in the January 2021 edition of *American Funeral Director* titled “*Don’t Buy a Job ... Buy a Business.*” This article gave the buyer a step-by-step outline to follow along with some general guidelines in hopes of steering an interested buyer in the right direction. As promised, we are now following up with some advice on selling your funeral home.

Both buying a business and selling one are equally important and will likely connect the dots of many years of dedication and sacrifice. Bookends, if you will, to a rewarding career full of many hours worked, countless family events missed, and seamless service provided to grieving families that called

upon you to serve them during their darkest and most vulnerable moments. Now you are looking at your options for a well-earned exit strategy. You owe it to yourself, your family, and your community to accomplish this in a manner in which everyone benefits. Where do you start? Right here. Take a seat. Relax.

If done correctly, selling your business does not happen overnight. It takes many years of thoughtful planning. In fact, based on our experiences with clients in your exact situation, we suggest a minimum of five years of planning.

Now let’s go back in time five years to when you should have started contemplating retirement and making these plans. This five-year period gives you the perfect opportunity to streamline your operation in order to make the books look their very best. Why? Because that is what is actually going to be sold.

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Yes, a buyer is purchasing a beautiful building appointed with all the finest décor along with a fleet of state-of-the-art professional vehicles and an inventory second to none. Oh, and don't forget the preneed portfolio that you have been building up for many years. Not to say that these items are not important because they most certainly are, but that is not what you will be selling. What you are actually selling is the cash flow value or earnings potential of the business. An investor wants reassurance that, at a certain selling price, the business is fully capable of paying its own way and providing a solid return on the investment.

You can ask whatever you want for your business but it must be a reasonable asking price, it must cash flow, and it must be profitable. Otherwise, you don't really have a business to sell. In that situation you merely have assets of a business that should be sold piecemeal, and the company would be liquidated once buyers are found for the assets. But you have a business to sell and have no intention of simply selling off assets and closing up shop. Your shingle has been hanging in your community for many years and your goal is to ensure continuation. So, let's focus on your goal and work through the basics.

Keeping in mind the importance of a fair and reasonable asking price, it should be noted that lenders also seem to be very interested to know that the business can service the debt and be profitable. Why does that matter since you're not the one borrowing this time?

Lenders tend to be less interested in lending money for businesses that aren't profitable and few funeral homes are sold without the involvement of lenders. They play a pivotal role in your succession plan. Five years should give an owner plenty of time to develop a strategy to maximize the selling price. Don't you deserve to be paid a premium for your business? That is how every seller feels and rightfully so.

A great point to make to encourage a close watch on expenses during this fiveyear plan is that if a funeral home sells for approximately 8 times EBITDA (earnings before interest, taxes, depreciation, and amortization) and please keep in mind this is simply discussion; if expenses can be reduced by just \$10,000 annually, this would increase the value of the business by \$80,000 ($8 \times \$10,000 = \$80,000$). That is a very strong rate of return and hopefully emphasizes the importance of watching expenses closely. A seller should also take this time period to pay down debt and create a cash reserve. The business must look like a picture of financial health and stability.

These measures will give you leverage during negotiating the sale of the business. Leverage is what you want to have in any negotiating situation.

Once you have the business operating at its optimal potential, you can then explore the process of selling. And remember it is a process, and it is a process that takes time to do correctly. Good results are well worth the wait. You've gotten this far in your career. Why not end on a high note? Be patient.

What is best for the seller? It depends. What is best tax-wise? It depends. How should the sale be structured? It depends. Hopefully you are picking up on a pattern here. The only answer that is accurate one hundred percent of the time when it comes to tax or entity structure is "it depends." Every single situation is unique, and you must have someone on your side that fully understands that uniqueness and how the many options apply to you and what will be most advantageous based on your particular situation.

Your first step is to identify a buyer. Is there an obvious heir apparent? Do you have a key employee that you would like to see as your successor? What about approaching your competitor? Given the extremely competitive nature of the funeral profession, this usually causes some indigestion but keep in mind that

your business is likely more valuable to a competitor than any other potential buyer outside of family members or key employees. Why? Because the future of the funeral profession and success is volume and roof tops. The business term is "economies of scale." Gone will be the days of a medium size community having four or five funeral homes for a family to choose from. The opportunity of buying a competitor only comes around once every 20 to 30 years. Keeping all options open provides the seller with some additional leverage during the negotiations. Again, leverage is what you need. If none of these options fit, then it might be a good time to contact a third party such as a broker that deals with this on a daily basis and specializes in selling funeral homes and related businesses.

You will need expert tax advice throughout the entire process of selling. This is going to cost some money but you cannot afford to be penny-wise and dollar foolish. It is an investment in your future pure and simple. Remember how insulted you were when a family had the nerve to question your professional fees? Why did you get insulted? Likely because you understood the amount of time and resources it took to provide a high level of service. The same goes for other professions as well.

Once you have identified a potential buyer and well before you enter into any negotiations or disclose financial statements, tax returns, etc., you need to have some very important documents in place. The first being a nondisclosure agreement signed by both you as the seller and any potential buyer. These are simple straightforward documents but do not do anything related to the potential sale until one is in place. This document will be followed by a letter of intent that is drawn up by the interested buyer and will give a general outline of the terms of the sale such as price, what is being sold (assets of the business or stock of the business ... this will be explained a little later on), an asset allocation (breakdown of the selling price), and most likely the general parameters of a covenant-not-to-compete. Once the LOI is signed, the buyer takes that to his or her lender to begin the loan application process. Sometimes the buyer may ask the seller to carry a portion or all of the sale price in the form of a seller-carry promissory note. This is very common. Remember that the more hats you wear in a deal, the more money you are likely to make over time.

Once financing is approved either by you in the form of a seller-carry note or financing from an outside source such as a bank, the attorneys will draw up Purchase Agreements and other relevant documents such as a non-compete

contract. This takes time to draw up and even more time to negotiate. Be patient.

As the seller, you need to decide on how to structure the sale. What do you mean? Once we agree on a price and financing is approved, we go directly to closing, right? Wrong. The game has just begun.

Selling is a process and a process that may take up to a year to finalize. Be patient. Taxes will have a significant impact on your financial future. Take this time to consult with a tax professional.

Know how your business is structured and more importantly how it is taxed. Do you know how your business is taxed? (Hint: proclaiming that your business is excessively taxed is not the answer we are looking for). If you don't already know, you will need to find out whether you are taxed as a sole proprietor, partnership, S corp, or C corp. Those are your multiple-choice answers. It should be mentioned an LLC (limited liability company) isn't a definitive answer when determining how you are taxed since an LLC is a legal structure that can be taxed multiple ways. If the LLC is a single member, it defaults to being taxed as a sole proprietor. When there are multiple members in an LLC, it is taxed as a partnership. However, a single member LLC as well as a multiple member LLC can elect to be taxed as a corporation.

Diving even further down the proverbial rabbit hole, once taxed as a corporation, an LLC can then elect to be taxed as an S corporation. Each of the four are taxed differently and it is very important to at least have a basic understanding of each.

You are now very likely asking which is best? It depends (remember that's the correct answer to nearly every question related to tax or entity structure). Each offers pros and cons, and remember that your particular tax situation is different and unique. Please note that the IRS frowns upon switching entity types frequently and there are very strict guidelines you must adhere to in order to change entity types and how you are taxed. They make the rules. You have to follow them. So, most likely how you are set up currently will determine the tax implications of the sale. If you are uncertain as to how your business is taxed, a quick look at your most recent tax return will help guide you. If you are taxed as a corporation, you are required to file Form 1120 with the IRS. If you are taxed as an S corporation, you must file form 1120-S and each shareholder will receive a K-1 that will be used to file their personal tax return. Partnerships are required to file Form 1065 and K-1s issued to each partner. Sole proprietors file a Schedule C on their personal tax return. Funeral homes are usually taxed as a corporation.

Partnerships and sole proprietorships are the minority. So, let's focus on corporations and how taxes influence the sale. Your first option is to sell the assets of the corporation. The buyer, in turn, places these assets into their own operating entity. The major advantage to the buyer in this situation is that because the assets being purchased are new to their business, they get to "re-depreciate" those assets which will likely provide them with a tax break. The second advantage to a buyer is a legal one and that is the buyer does not assume any liabilities known or unknown because they will not be operating under the same entity that would bear that liability. They cannot be held liable for something the previous owner did or did not do such as cremating the wrong body two years prior to the sale or not paying suppliers. An asset sale is a very common method of selling when it involves unrelated parties or someone other than a key employee. Once you have paid all your liabilities and collected all of your accounts receivable, your corporation will likely be liquidated and closed. What will the tax consequence be with an asset sale? It depends. It depends on many factors but mainly whether you are taxed as an S corporation or a C corporation. And it depends on other considerations such as the basis of the assets being sold and the seller's stock basis in the corporation once liquidated.

When assets are sold from a C corporation, there is what is referred to as “double taxation.” That sounds horrible and most often it is just that. The assets being sold will be taxed at the current corporate rate of 21% and then the stockholders (sellers) will be taxed at the personal level when the liquidating dividend is issued and the corporation is dissolved. The tax rates on the liquidating dividend vary depending upon the stockholder’s taxable income and filing status and is reduced by the stockholder’s basis in the stock being exchanged for the liquidating dividend. And don’t forget the Net Investment Income Tax of 3.8%. Oh, and state tax, too, at the corporate level and then again on the liquidation. A quick note regarding corporate tax rates: the current corporate tax rates have been reduced since the Tax Cuts and Jobs Act of 2017 which lowered the corporate tax rate from a graduated rate topping out at 35% to a flat rate of 21%. So right now, being a C corporation is not as disadvantageous as it once was.

S corporations are much trickier.

Each asset is taxed differently, and the tax occurs at the personal level. S corporations do not pay federal corporate tax. Some states do have a tax at the corporate level. Instead, S corporations are what are referred to as “pass through entities” and any tax is passed on to the shareholders of the S corporation. As previously mentioned, when an S corporation sells its assets, each asset class is taxed at different rates. For example, the depreciation used on a

building which gave a tax break when expensed is taxed back at what is called “recapture” and that portion of the sale is taxed at ordinary income rates. Any amount above the original cost basis of that same building will be taxed at more favorable capital gain rates. Automobiles, furniture, and equipment are taxed at ordinary income on any amount over the basis of the asset. Goodwill is taxed at capital gain rates and any non-compete contract is taxed at ordinary income rates. Should a seller-carry note be involved, the interest on the note is taxed at ordinary income rates.

Now you might be understanding why it takes so much time to negotiate the sale and to close the deal. Given the complexity of these transactions, cutting corners and not hiring experts to guide you is not a wise financial move. In fact, it is likely going to be a very costly mistake not to have invested in hiring qualified expertise. When an asset sale occurs, regardless of entity type, the IRS requires that Form 8594 be filed. This details the exact asset type and the amount of the transaction for each. The buyer and seller are both required to file this form and the amounts must match. Keep in mind this form and these amounts will determine a buyer’s depreciation and amortization schedules as well as how the seller’s tax is calculated.

A second method of selling a corporation, whether it is a C corp or an S corp (or an LLC taxed as a corporation) is to sell the stock of the corporation.

This would avoid any double taxation on the sale and also avoid the complexities of assets being taxed at different rates when selling assets of an S corp. The stock of the corporation is simply sold directly to an interested buyer or could be redeemed (bought back) by the corporation itself. There are reasons one might be preferred over the other. Either way, assets are not being sold. Only the stock of the corporation is being sold or redeemed. These are more often than not very simple to transact. The advantage to a seller is that any tax implications should be much less since taxes are calculated and paid as capital gain on any amount above your stock basis. Capital gain tax rates are normally more favorable than income tax rates. The disadvantage tax-wise to the buyer is that the depreciation of the assets remains unchanged (they don't get to start depreciation over again). There is also a legal concern in that if the buyer purchases the stock, he or she is assuming all liabilities either known or unknown. The buyer could be held responsible for something he or she had no involvement in at the time it occurred. Banks are often not too excited about lending money on stock transactions.

And speaking of banks, if there are liabilities on the books, an inquiry should be made to the lender to see if they would even allow a stock sale or if a personal guarantee is tied to a loan and whether they will remove the current stockholder(s) and replace it with the new. Please note that the sale

of businesses taxed as a sole proprietor or partnership cannot be structured as a stock sale because those types of entities have never issued stock (only corporations or LLCs taxed as a corporation issue stock).

There is a way to structure the transaction where the parties involved can have their cake and eat it too. It involves treating a stock sale as an asset sale so that the seller can get favorable capital gain treatment on the tax triggered as a result of the sale and the buyer can take advantage of depreciating the assets as though they were acquired in an asset purchase. It is found in the Internal Revenue Code (IRC) Section 338(h)(10) and is an election that would allow recharacterization of the stock sale to an asset sale for tax purposes. Both buyer and seller must agree to the election. It is only briefly mentioned in this article and given the amount of information and complexities involved could be an article in and of itself. Please consult your tax professional for any further guidance.

Hopefully the point has been made that selling a business is not as easily accomplished as it may seem. There are many factors involved and is something that should not be entered into without fully exploring what options are available. Minimizing our tax is as important as the selling price. It all works hand-in-hand. This brief article should in no way replace any type of professional advice but should be used only as a reference. The goal

was to open a seller's mind and eyes to the fact that these transactions take many years to form and much time and resources to optimize the results.

You've earned it! The beach is waiting ... can't you hear the ocean? Oh wait, that is the sound of the hydro aspirator going. Sorry. Get back to work! 🌴



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