Selling your business - What are you really selling (S3E59)

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00:06 Speaker 1: Welcome to The Legal Roadmap podcast for online and ecommerce entrepreneurs. I'm your host, lawyer Autumn Witt Boyd.

00:13 S1: I'm an experienced copyright and trademark lawyer. With my team at the AWB Firm, I leverage, grow and protect multimillion dollar online businesses. My goal in every episode is to teach you about the sophisticated legal and business strategies to build your own seven or eight figure business. If you're a new business owner, go back and listen to episodes, one through 12, you'll learn the basics to set up a strong legal foundation.

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00:52 S1: Hi Facebook friends and Legal Roadmap podcast listeners lawyer Autumn Witt Boyd here, I am excited to talk to you today. We are going to be going through part three of my series on selling or taking investment, in your business. And today is all about figuring out what it is exactly that you are going to be selling, which seems like it should be an easy thing to figure out, but often, isn't.

01:15 S1: So I wanna get your gears turning if you are thinking about selling, or taking an investor in your business, or maybe bringing on a partner.

01:21 S1: Figuring out what that is actually going to look like.

01:24 S1: Last week, we talked about due diligence, so that is the part of selling your business where it's basically an investigation into your business. So how can you get ready for that? And then in the first episode in this series, two weeks ago we talked about just basically getting your business the foundation set up the right way. So if you're thinking you might want to exit your business at some point in the future, what are the things you need to do now so that you are ready down the road when either an opportunity presents itself, or you are ready to kind of go to market and try and find a buyer or an investor in your business? So definitely go back and listen to the past two episodes. If you haven't already, they will help you as you're listening to this one have more context.

02:03 S1: I will get my standard disclaimer. So I am a lawyer, I am licensed to practice law in Tennessee. If you have specific questions about your business, please do not rely on this podcast, this is just information.

02:16 S1: So we are going to be giving a high level look at some of these topics, but if you are looking to sell your business definitely talk with your own lawyer. This is not legal advice, so please do not rely on it as such.

02:28 S1: So when we are going to go through what kinds of things you might be selling when you sell your business, I'm going to start by talking about three common ways that people structure the sale of a business.

02:40 S1: And again, you might think if you've never been through this process before, I mean you just sell your business as a sale, as a sale, as a sale, but that is not true. And I am going to give again a very high level overview of this area. This is one area of the law, where if you are doing your own sale of your business, there are often hundreds of different choices you could make at each step. Lots of different ways that you can structure. If you wanna get into really complex areas, you can do that with an experienced lawyer who handles these kinds of transactions. I'm giving you a very high level just talking about some of the most common ways that these things are structured. But just know I can't cover everything in this 20 to 30 minute podcast episode and Facebook Live. So, if you are wanting to dig deeper definitely again, talk with your lawyer, whether that's me or someone else who handles these kinds of transactions all the time. They are going to be able to talk you through your options and help you figure out what is the best choice for your own business.

03:36 S1: So the three types of transactions we're going to talk about today are an asset sale, a stock or membership interest sale and a merger.

03:45 S1: So just to kind of give you the overview. And then at the end of this episode, we will talk about how you figure out what kinds of things you are including or excluding in the sale of the business and how that might look. And I have a resource to help you. So definitely, stay tuned and listen for that.

04:00 S1: The first one, an asset sale. An asset is basically just something that your company owns. So think about it, it could be a physical thing like a piece of equipment or your office furniture. Look around your office, if you're sitting in an office or if you're in a building, maybe you're a manufacturing business, kind of... Everything around you could be an asset. So it's gonna include physical assets.

04:23 S1: It's also going to include intellectual property. So what we think of as intangible assets. These are things like your brand name, so trade marks if you've got copyrights in your business, if you maybe are in an online business like my firm works with primarily you may have a lot of intellectual property that may be the primary asset in your business. If you're selling an online course that's protected by copyright law, that is an asset that's a copyrighted work. If you are selling products under a brand name and it's very well recognized like Coca-Cola. The Coca-Cola brand is one of the primary assets of that business and the recipe for Coke is a trade secret. That's another intangible asset, you can't...

05:01 S1: Well, I guess you can hold the recipe in your hand, but the value is not the piece of paper, it's not the tangible asset, it is the idea of the recipe and how that is their secret sauce. So... And when you're thinking about an asset sale, you are going to be picking and choosing different assets in your business that are going to be sold to someone else. So it's not necessarily that you're selling everything that's in the business, it's going to be particular assets and potentially specific liabilities. So when we talk about liabilities that is just a big fancy legal word for something that is either a risk or a cost to the business. So think about if you have had a claim made against your business, maybe someone fell and was hurt in your store and they are suing you for a personal injury, that is a liability that means that you could have to pay out money in the future or now, [chuckle] depending on what stage of the lawsuit you're in. If you have someone who has accused you of copyright infringement, that's a liability. If you've got an employee who is disgruntled and has filed a claim with the state to maybe they have accused you of bad employment practices and you could potentially owe a fine that could be a liability.

06:11 S1: Also, if you owe money to people. So if you have taken out a loan on your business either you know or if it's tied to a piece of property or a piece of equipment or maybe you just have a working line of credit and you have a balance on that so it's money you owe to people.

06:23 S1: Or if you have accounts payable that you owe other people, maybe you're build on 30 or 60 days. So payment isn't due today, but it is an outstanding debt. Any kind of debt is also going to be a liability.

06:35 S1: So in an asset sale you have assets on one side and maybe liabilities on the other. But again, you're gonna be picking and choosing the buyer may not want all of your assets, they may only want certain assets and they are probably not going to want all of your liabilities although there are some rules. And again, I am not gonna delve deep into this area, and that is going to vary state by state and there are some federal rules about this too. Some liabilities go with the asset. So think about a piece of property, if you... Like, a piece of real estate, if you are buying that piece of real estate you may be taking on environmental liabilities, let's say, the business that was there before you went out of business, but, they damaged the land, they have polluted the river or they have... Maybe it was a gas station and there were leaks. There are some situations where if you're purchasing that property, you could be taking on those liabilities like it or not. [chuckle]

07:25 S1: There are some liabilities you cannot get away from but some you are able to say, "I will take this asset but I do not want that liability. So when you're thinking about an asset sale think about picking and choosing.

07:37 S1: And because of that, these tend to be... And again, this is a big generalization that these can be more complicated transactions because it's really important that you have a really clear list of what assets and liabilities are being transferred and what are not to the buyer. So your gonna wanna have to be very specific.

07:55 S1: Another tricky thing with an asset sale is that because the person who's purchasing the assets they're not taking over the whole company, the company will probably either be closed or it may continue but without those assets it may do something different or it may do something similar but in a different capacity without the assets that are being sold.

08:16 S1: So, since the buyer is not just stepping into the shoes of the company, they are usually transferring those assets to either a new company or maybe taking them, absorbing them into an existing company, they may have to take over contracts that are related to those assets.

08:32 S1: So for example, let's say you run a bridal shop, I have a client who runs a bridal shop. And when that bridal shop was purchased, they took over the lease, for the physical bridal shop.

08:44 S1: That had to be assigned from the seller to the buyer that required the approval of the landlord. So when you're looking at an asset sale since you have a new company coming in, there may be contracts. And I mentioned this in the last two episodes there may be contracts that have to be transferred from the old entity to the new entity.

09:04 S1: So you may have to get approvals. There are just some extra steps involved and it may be that that landlord doesn't wanna give the approval, and so that could be a big hitch in the plans.

09:15 S1: So with an asset sale you are gonna have to have more specificity about what exactly is being transferred. It does give you a lot of flexibility. So let's say the buyer really likes this part of your business, but doesn't really like that other part of your business, maybe you've got a couple of different lines of products that you sell and they really want the profitable one, but they don't want the conquer that isn't making very much money. With an asset sale, you have the opportunity to do that picking and choosing, but because of the approvals that are sometimes required that can make things a little more complicated. So the second type of transaction that we see really frequently it's going to be a stock or membership interest sale. So we're thinking about stock, if it's a corporation because that's how people own parts of a corporation.

09:56 S1: We have shareholders or stockholders, and their interest in the company is called stock. If it's an LLC, a limited liability company, the owners are actually called members.

10:07 S1: Don't ask me why I do not know, but it's just a little bit of a different terminology. So, if you are selling a corporation, it's gonna be a stock sale, if you are selling an LLC, it's gonna be a membership interest sale.

10:19 S1: With that. It really is you're selling the whole darn thing.

10:22 S1: So it is the whole company is being sold. So whatever the company owns, that is what's being transferred. There's none of this picking and choosing, you're pretty much, you know, it's lock, stock and barrel. If something is owned by the... If there's an asset in the company, if there's a liability in the company, all the good and the bad, the buyer basically does step into the shoes of the company, the company can keep operating as it was. And you just basically are switching out one owner for another owner.

10:48 S1: In one way of looking at it, a stock sale, can be more simple if you have multiple shareholders though, like let's say you've got five different owners, of a single company or five different members of an LLC, and they all own different percentages of the company.

11:05 S1: You may have to get approval of all of those people and that's gonna depend on how the company is set up, that's gonna be in there. Corporate bylaws, if it's a corporation, or the operating agreement if it's an LLC. In those corporate documents you're gonna have to see what are the rules. Does everybody have to agree? Do you have to get unanimous consent, is it majority? Are there protections for the people who have less shares so that maybe they can override the majority? There could be all kinds of complicated things built into the corporate documents that you as, if you were coming in as the buyer may not know about.

11:38 S1: So getting those approvals and going through that process can be more tricky especially if you have one squeaky wheel let's say you've got five people, four wanna sell and one does not, that can make things really, really tricky. So in some instances, a stock or membership interest sale can be really simple, but in other instances it's not necessarily. Again, as I mentioned, with a stock or membership interest sale you are generally not going to have to get all of those approvals that I mentioned before, for transferring contracts, because nothing's really being transferred. The company is still operating, if the company is the one who has the contract. Let's say you have... Let's say you are a web design shop and you have a contract with a big local company to do their website and it's an ongoing contract and it's high dollar, it's very valuable to the business, and maybe that contract has a clause that says, "No assignment." So you can't... You can't transfer that contract to a new company but with a stock sale, or a membership interest sale you're not transferring anything, it's just a new owner of the same company. So you wouldn't have to get that client's approval for that deal.

12:41 S1: So that can make it a little bit easier to do a stock sale, or a membership interest sale because you do have that simplicity of not having to transfer anything. Same thing if you had a lease on a building or something like that.

12:52 S1: Now I will point out some contracts, especially if, I mentioned with a web designer especially if it's a creative type service, some contracts will have rules where if you have a change in control, of a company that that is a problem that that contract will not be allowed to continue. Because let's say that my client Jane is an amazing graphic designer, and this company has hired her because they really like her work, they think that she's really talented. If she sells her company to Joe, her client doesn't know Joe. They don't know if Joe's talented or not, they really want... They really wanted Jane they didn't really want her company, they really wanted Jane. So there may be still some trickiness, even if you're doing a stock or membership interest sale, where if you have a change in control clause. So that's just something to be aware of. Something to look out for. The third type of transaction that we see very frequently is a merger.

13:44 S1: So this is where you take two companies and they combine into one. There are lots of different ways that this can happen, we often will talk about a target company. So that's the one being bought. So sometimes the purchasing company will merge into the target, sometimes the target will merge into the purchaser, and sometimes they create a new company that everybody merges into. There's all kinds of different mergers that you can set up. It can get very, very complicated as you might imagine. But the nice thing about a merger is it is very flexible. So there's lots of different ways you can set it up depending on what your goals are, and how you want things to look.

14:21 S1: One thing I will mention is with each of these three different options... And these are not all the options out there. There are other [chuckle] ways to structure these transactions. These were just three very common ones that we see. There are going to be tax consequences. So, if you are selling your company, at some point you invested a certain amount of money or maybe you have a certain amount of money that's just sitting in the company that you haven't taken out. It's profits. There may be tax consequences if you are getting paid for your interest in that company.

14:51 S1: And that is going to look different depending on whether it's structured as an asset sale. Are you selling assets, are you selling your shares or your membership interest or is it a merger? So this is definitely an area where you are going to wanna be talking with a tax professional, either a CPA or a tax advisor early in the process so that you know what this is going to look like. I have been involved in transactions where we structured a deal. We had the outline of the deal at the beginning, we were pretty sure that it made sense for everybody, everybody was pretty happy, and then we brought in the CPA and when we realized what the taxes were going to be, the numbers no longer made any sense. There was gonna be so much owed in taxes that there was pretty much no benefit to selling the business and the owner was going to walk away with actually owing more money than they were taking with them. So you definitely are gonna wanna get a CPA or a tax advisor involved early so that you know what you're facing before you spend a bunch of money on due diligence.

15:45 S1: Like we talked about last week, it is expensive and time consuming. You're gonna need a lawyer involved, it's gonna take your team member's time and energy. You may have to get other professional advisors involved.

15:56 S1: So due diligence, that investigation where the buyer is checking out your company and trying to decide if you're a good investment or not, and whether the purchase price makes sense, that is expensive, so you're gonna want to know what the tax consequences are of the deal before you get too far down that road.

16:12 S1: The good news is, unless everything is set in stone usually up until closing, you have a chance to negotiate and to maybe move things around or change the structure so that if both sides really want the deal to go through, they can make adjustments and make changes so that the taxes don't become such a problem.

16:31 S1: That is where those CPAs... I know numbers are boring and not all of us love to look at that side, but a CPA is worth their weight in gold in a transaction like this to make sure that you are taking advantage of the right things in setting up a deal.

16:46 S1: You definitely want someone who knows their stuff and has dealt with similar transactions. You don't want somebody that all they do is tax returns. You want someone who is a small business CPA who can help you work through these issues. So the fourth thing and this is not really a transaction, it kind of is.

17:00 S1: But I wanted to mention as part of this series, I've also been talking about maybe taking on an investor or a partner to your business as a way that maybe you just wanna take a step back, but you don't wanna get out of the business altogether.

17:12 S1: So if you are taking on an investor or a partner depending on again if you're a corporation or an LLC, usually, that will happen through a sale of part of your shares or part of your membership interest, and so that will transfer then to that investor, or that new partner.

17:29 S1: The way that will work is just like I talked about it above when we were talking about a stock sale, or a membership sale. They really are now stepping into your shoes. They get a percentage of all the assets and all the liabilities that the company owns. They're not picking and choosing, they're really just stepping into the shoes. They are now an owner of the company and they have all of the benefits and responsibilities of being an owner into the company. There are ways, I get questions about this a lot with if an investor or partners coming in and maybe the business has already been running for five years or 10 years or longer, and they're worried that there could be problems with the business or there could be things, the business has done wrong that they don't wanna be on the hook for because they weren't involved. They are new to the business. And there are ways that you can structure things to protect a new owner or new shareholder or partner in that scenario, but it's definitely something you want to talk with your lawyer about because it is, it is not standard so it's definitely something, if that's something you're concerned about that, you need to make sure that the deal is structured in a way and that the contracts are going to protect you in that way.

18:35 S1: Now, the thing to think about here is a corporation or an LLC the whole goal of that having that entity is to protect you personally from the liabilities and the risks of the company. So I like to say think about your personal assets are outside of the fence and the business is inside the fence, so it kind of fences off your personal assets, your bank account, your car, your house, from anything that goes wrong with the business, the business stays inside the fence you are outside the fence. If something goes wrong with the business, they are not going to be able to come outside of the fence. Now, what cannot be done is, whatever you've invested into the business cannot be protected from things that happened before. So let's say you spend $100,000 to buy a percentage of an existing business.

19:26 S1: Once you put that into the business. It's kind of gone it is in the business now, it is subject to if something goes wrong with the business usually you cannot get that back because that is no longer your money that is now the business's money. Of course, there are ways that you can build in some protections but it's much more difficult once the money is in the business or if you've given real estate or equipment or other kinds of assets to the business typically you can't just get that out. You now you're in line with every other creditor of the business and usually owners get paid less. So if you do see a business that has some significant risks prior to you coming on as an investor or a partner that's definitely something that you're gonna wanna do a lot of investigation on and make sure that you're comfortable with that, especially if you were buying it or if you're contributing something it's definitely tricky.

20:18 S1: All right, so the last thing that I wanted to talk about is figuring out what are you going to include and exclude from a transaction like this? So this is really something to think about, even if you are wanting to do a wholesale stock sale or membership interest sale so that you're totally turning over the company, you're not picking and choosing assets, but it's important to figure out first what assets and liabilities does the company even have. I mentioned last week during the due diligence episode that this is a good exercise to go through but I think it's really critical, before you even start talking to purchasers or a potential partner or investor to figure out what does the company own and this is where I'm gonna mention the resource that I have and that is my five-minute IP audit, which you can find on the website, it's awbfirm.com. If you just go to the main podcast page, you can download it right there, it's awbfirm.com/podcast and you'll see right at the top of the screen there. You can get it right there.

21:16 S1: I think it's fairly easy for most of us, to inventory the physical assets of our business, and if you work with a tax preparer, hopefully, you already have kind of an inventory because you may be taking depreciation on some of those if they are larger purchases, like big piece of equipment. You wanna be sure that you're showing that on your taxes so that you are getting deductions for that but, it's a little trickier to do an inventory of your intellectual property, your intangible assets. So, this worksheet, the five-minute Audit Worksheet is going to help you figure out what IP is actually in your business. So what could be a trade mark what could be protected by copyrights? Those are different things and they can be a little tricky to figure out. It will also help you think about trade secrets.

21:58 S1: Which I think it's probably the most overlooked intellectual property in a lot of people's businesses but there is value there. And the other reason this is important, in addition to helping you figure out what does your business own when you're looking at the tax consequences for the sale of your business or taking on an investor transferring assets in or out different assets are going to have different valuations and so you may want to work with your tax advisor, on assigning value in different places because of the tax consequences that are gonna follow depending on those different kinds of assets and what the value is. So you're gonna wanna know what are your physical versus intangible or intellectual property assets, that's super, super important. And you can get a big tax advantage, depending on how that's all categorized.

22:42 S1: The other reason this is important is because I know a lot of small business owners and I am certainly guilty of this, as well. We may run things through our business that are not really part of the core business so we might want to sell a business, but we've been kind of running a side project through our business, and there's no rule against that there's no problem with that, but it might be something that really should be extracted or should live, in its own LLC or corporation or should just kind of be a sole proprietorship. There's lots of different ways that you can split things out, but an example of this would be, maybe you started a podcast with a friend and it's about a topic that's kind of adjacent to your business, but it's not part of your core offerings, it's not pitching your products, it's not about the services you're offering.

23:30 S1: And so that doesn't really belong in your business. So you would wanna make sure before you're talking to an investor or a partner or a potential purchaser that that is excluded, that that is moved out of your company so it's clear that your company if it is sold that sale would not include that podcast that you've been doing with this person on the side. And some other examples would be maybe you just have a personal passion project, maybe you do artwork on the side, and maybe you've been running those expenses through your business and you've been selling under your business name, but if you are going to sell the business, you might wanna keep doing that, because it's personal and you enjoy it.

24:06 S1: Maybe that needs to move over into a sole proprietorship or its own LLC or corporation. So you can be clear that any artwork that you haven't sold yet, is all those copyrights. Live in a separate company, or just your own self personally, and that they're not held by the company by the company that's being sold. So we wanna be really clear on what are the assets of the business and what maybe needs to be carved out. And this is a great thing that you can work on after you do your IP audit and you look at all the things that are housed under your business, you can kind of figure out, "Oh I need to split that off. If you've got a copyright or a trade mark registration maybe that needs to be assigned or transferred somewhere else.

24:45 S1: So that if a partner or investor comes on, they are not gonna now own a part of it. The other reason this is really important, I would say, especially if you're looking at taking on a partner, or an investor and not just a total sale of assets or your business is because once you bring out on a partner or an investor, they are now going to have a claim to those assets, if you have a break up. And so, I know at the beginning when everyone's friendly and we're all thinking that good things are gonna happen and we're gonna do amazing things and grow this business and make a million dollars or more than a million dollars.

25:18 S1: Nobody thinks about the downsides but the fact is a lot of business partnerships do not work out. Just like marriages, it's a business marriage. So I want you to think carefully if there are things in the business that really probably don't belong in the business because you would be absolutely devastated if a partner left, and try to take a piece of that.

25:38 S1: So this, for example, let's say you are teaching a course about something and again, maybe it's not part of your core business, it's just something, it's kind of a passion project or it's something separate that you do on the side about just something you're interested in. I have a client, for example, who does marketing she's brilliant at marketing and she also runs a retreat for creatives, but she's really passionate about gardening and so she has some projects and products related to gardening and so that might be something if she were going to sell the business that she'd want a carve-out that she'd want to keep, for herself. And again, if a partner or an investor, were coming on board, she might want to carve that out, so that if the partner decided to leave, and let's say the garden stuff were really takes off, she would wanna keep that for herself instead of having it be part of the business?

26:23 S1: So, it's something you definitely want to think about before you get into that purchase conversation or that partnership conversation, so that there's no questions about what's in or out of the business. It's very clear, and you can kind of draw a line in the sand and everybody knows where things stand. Where I have seen hard feelings or complications is where one person thought something belonged to the business, the other person thought it belonged to them personally, the first lawsuit that I handled after starting my own firm, was a business break-up, and it was just absolutely heartbreaking. My client strongly believed that I believe her, that you know some of the copyrights belonged to her personally and were just basically she had given permission for the company to use them and the other partner disagreed and thought the company owned them.

27:06 S1: And they had nothing in writing about that issue, and so that became very complicated and required running to federal court, which is incredibly expensive. So again, this is something where you can save a lot of time and energy and money on the back end by a little bit of planning and foresight and just having conversations on the front-end. This is something it doesn't have to be awkward, and expensive, but just making sure that you know what does the company own, what do I own and maybe what does another company or another entity own.

27:35 S1: So that again that IP audit will help you figure that out and that's gonna be at awbfirm.com/podcast you can sign up for that so that is gonna wrap up my episode on how you might structure a transaction and what is gonna be included and excluded when you are selling a business or taking on a partner, or an investor. Next week I am going to have a special guest, I'm going to be interviewing my friend Shannon Farr she is here in Chattanooga she is a CPA by training, but she had started her own consulting firm where she works on business valuation so she helps people figure out what the heck is their business worth. And she works on both sides. So if you're trying to sell your business and you're trying to figure out what sales price is appropriate to ask or if you're purchasing a business and trying to figure out does this purchase price makes sense, is it supported by the value of the business? And can I make a profit if I pay this purchase price moving forward?

28:28 S1: So she is gonna talk about what to think about how she does evaluation and I'm sure it's gonna have some helpful tips. So if you have questions about that, be sure to go on our Facebook group, it's the legal Road Map Facebook group and post them there. And I will ask Shannon about those for sure. That's gonna be next week, Shannon Farr talking about valuation of a business, how much money is your business worth? I know this is a million dollar question literally so thank you so much for tuning in again, check out our legal Road Map Facebook group if you haven't already that's where you can ask all kinds of questions, including about buying and selling a business, or business valuation. And I will talk to you next week. Bye guys.

[music]

29:12 S1: Did you know that you could be making more money from your copyrights and trademarks. Intellectual property is probably the most valuable asset in your creative business but most entrepreneurs don't know how to identify it and you can't monetize what you can't find. Download my free of five-minute IP Audit Worksheet at "awbfirm.com/podcast you'll find out what parts of your brand logo images, website, courses, digital downloads, or other content could be protected by intellectual property laws and you'll create an inventory of your most valuable trademarks, copyrights, patents or trade secrets so you'll know what's worth protecting as you build a more profitable and sustainable business. Get your five-minute IP audit worksheet now at awbfirm.com/podcast.