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Selling Your Heavy Equipment Company, A Stock Sale is Preferred

By Steve Pierson CPA and Dave Kauppi, CBI

As Merger and Acquisition advisors for the Equipment and Construction Industries, our goal is to maximize our seller clients' after tax proceeds. The first step is to get the best price from the marketplace by presenting the acquisition opportunity in a competitive bid situation. Having several interested buyers is the most important factor in achieving the best sales price.

However, the unique nature of the balance sheet of a heavy equipment dealer makes the form of transaction especially important. First rule of thumb in the sale of your privately held business is to have the corporation set up as an S Corp, LLC, or Partnership rather than a C Corp. The reason for this is that buyers prefer an asset purchase versus a stock purchase. If you are structured as a C Corp there is no such thing as long-term capital gains for tax purposes.

So if you have an asset sale of a C Corp, then your gains are taxed first at the applicable corporate tax rate and then taxed again as long term capital gains when the proceeds are distributed to shareholders. This can be particularly harsh to the seller because the sale will normally bump the corporate tax rate in the year of the sale to a much higher rate than it normally is for that company. Goodwill essentially has a basis of $0, so all of the purchase price allocated to goodwill is a gain. A C Corp, for example, might be taxed at a rate of 34% for the gain versus at 15% for the same gain for a pass through corporate structure like an S Corp.

Buyers prefer an asset purchase for two primary reasons: 1. They want to protect themselves from any hidden liabilities. When you do a stock acquisition, you inherit all assets and all liabilities. 2. The buyer gets to take a step up in basis on all hard assets based on the allocation of purchase price on the asset sale.

Many business sellers, in the heavy equipment business, however, miss a very important issue in transaction structure. They think that they have done everything possible to reduce their taxes because they are an S Corp and do not fight for a stock sale. This incorrect assumption could cost tens of thousands or even hundreds of thousands in after tax proceeds because of depreciation recapture. If your business is heavily equipment intensive and you have naturally taken depreciation, you are subject to depreciation recapture if you do an asset sale of your S Corp.

Let's say that your assets consisting of operating equipment plus rental equipment is on the books with accumulated depreciation of, for example, $2,000,000. Then this

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depreciation that you received as a tax benefit is recaptured in your asset sale and treated as ordinary income for tax purposes. This will most likely push the seller up to the maximum individual tax rate for this portion of transaction value.

If the sale had been a stock sale of the S Corp, there would be no depreciation recapture and the entire gain would be at the individual long-term capital gain rate of the seller. For discussion purposes, let's say your personal income tax rate were 30%, then the asset sale would cause you to pay an additional 15% (difference between personal income tax rate and long term capital gain rate) on the recapture amount of $2,000,000. You would realize $300,000 in additional after tax proceeds by structuring the sale as a stock sale.

So, if your business is an S Corp or an LLC, you have taken the most important step in maximizing your after tax proceeds from your eventual business sale. The next most important step is to get a premium from an asset buyer over a stock buyer to compensate you for after tax proceeds based on depreciation recapture.

Given the impact of taxes in the sale of your business, it is a very sound idea to get your tax accountant involved in the planning process before you start getting offers. You need to be able to compare the different proposals with an eye towards after tax proceeds.

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