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SMOOTH SAILING WHEN SELLING

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Thinking of selling your business? Then the time to get ready is now. All too often, the sale of a business is unnecessarily delayed or even scuttled because the seller did not adequately prepare. Imagine selling your house without cleaning, painting and fixing-up first.

The same care should be given to "housekeeping" matters for the sale of a business. This is especially true for those businesses that sell alcohol because of the significant government regulation involved, particularly where the collection of taxes are concerned.

Sales tax collection is perhaps the single most significant issue that arises during the course of a sale, catching both buyer and seller by surprise, unprepared for the delays and resulting frustration. What follows is a guide to help avoid the sharp rocks of sales tax problems that may lie hidden beneath the surface while cruising toward new opportunities.

Expect a sales tax audit. Connecticut law provides that a buyer of a business will be liable for a predecessor's unpaid sales taxes. Obviously buyers want to "cut off" any liability from the seller's sales tax obligations, so they will insist on a Department of Revenue Services (DRS) "Tax Clearance Letter" as a contract contingency. The buyer must request the letter from Department of Revenue Services (DRS) and provide it with information about the purchase. This request will automatically trigger a sales tax audit for the seller.

Prepare for the audit before listing your business for sale. Start by getting your accountant "on deck" for the sale and the likely sales tax audit. Addressing issues during the course of your own internal audit, rather than after a finding is made by DRS, helps control liability and avoid delays in closing that can ultimately lead to the breakdown of the sales contract.

Whether aided by an accountant or not, make sure your financial records are complete and organized. Arrange your records for the previous three years chronologically, grouped by record type. Include bank statements, deposit records, cash register tapes, "Z" tapes, income tax returns and wholesaler purchase records. Check for continuity from one period to the next and get duplicates of any missing records. Having your records in order and anticipating issues will speed the audit process. Remember, not having the paperwork available is never an excuse and may raise red flags. In fact, missing documents can complicate the audit by allowing DRS to establish total taxable sales through "any reasonably reliable" method.

DRS will already have a good idea of your taxable sales before the audit even starts. They require alcohol wholesalers to provide it with sales data on an annual basis. DRS analyses this data to determine individual retailers' inventory purchases as a way to estimate a given retailer's total sales. If your reported sales do not fall within the DRS's estimate, be prepared to explain why their sales estimate is not accurate.

Anticipate Delays of the Closing. Don't make the mistake of thinking you can sell your business quickly, at least without risking unwarranted sales tax liability. The sales tax clearance process can take up to five months from the day the Sales Tax Clearance Letter is requested to the day it's issued by DRS. Build time for a sales tax audit into your contract's key dates accordingly.

Escrow Letters. Sometimes a seller can't wait to close, maybe because the buyer won't agree to wait, or even for a seller's own personal reasons. Fortunately, DRS has its Escrow Letter procedure that eliminates liability to the buyer and allows the closing to proceed during the tax clearance process. While not ideal, Escrow Letters are helpful to sellers who are under pressure to get on with their future plans. However, a seller should expect that initially all of the net proceeds will likely be held in escrow. This is particularly true if the buyer waits to request the Tax Clearance Letter from DRS, forcing DRS to make a quick determination of an appropriate escrow amount. Sellers can reduce this risk by requiring in the sales agreement:

1. Immediate application by Buyer for the Sales Tax Clearance Letter;
2. The closing can occur after the receipt of an Escrow Letter (not the Tax Clearance Letter).

Waiting is too expensive. Your money can't work for you if it's held in escrow while DRS audits your books. Delays in closing may sink your deal and your new opportunities along with it, but you can ensure smooth sailing by preparing for the weather ahead.

The foregoing is intended as general information only and not as legal advice. Contact an attorney to get advice about your particular circumstances.

ABOUT PETER A. BERDON

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