

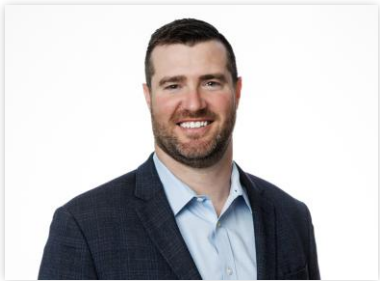
From Preparation to Proceeds:

# Key M&A Considerations for Business Owners

Erik J. Schumacher, CPA  
Principal | Advisory & Tax Services | Rehmann



# About Your Presenter



## **Erik Schumacher, CPA**

**Principal**  
Advisory & Tax Services  
616.975.4100  
erik.Schumacher@rehmann.com

### **Areas of Focus**

Tax Compliance & Consulting  
Transaction Advisory  
Tax Structuring  
Succession Planning

### **Experience**

Leadership team member of  
Rehmann's:

- Transaction Advisory practice
- Private Equity practice
- Cannabis practice

### **About Rehmann**

85-year-old firm | 23 offices |  
1,100+ associates | \$236M  
revenue

Services: Tax Advisory,  
Managed Accounting,  
Wealth Management,  
Investigations, IT Services

Member: HLB International  
Global Accounting Network

# Agenda for Today

## Pre-Sale Due Diligence..... 4

Critical seller-side steps to avoid surprises at close

## Net Working Capital..... 6

What it is, why buyers focus on it, protecting your price

## M&A Deal Structures..... 8

Asset vs. equity sales, tax impact, negotiation dynamics

## F Reorganization..... 12

S-Corp M&A strategy for most private S-Corp deals

## Qualified Small Business Stock..... 16

Tax exclusions, QSBS qualifications, planning strategies

## Key Takeaways..... 20

Prepare early, negotiate from strength, maximize after-tax value

## Q&A..... 21

Open discussion on your M&A questions





# Pre-Sale Due Diligence

Finding Issues Before the Buyer Does

# Pre-Sale Due Diligence – Seller-Side

## Why Seller-Side Diligence Matters

- Buyers run extensive due diligence. Surprises discovered late kill deals or create price cuts.
- Proactive sellers identify issues first, control the narrative, and negotiate from strength.

## Financial Records

- Clean, audited (or reviewed) financials for 3 years minimum typical.
- Normalized EBITDA with all add-backs clearly documented and defensible.
- Revenue recognition policies consistent and well-supported.

## Tax Compliance

- All returns filed, taxes paid, and state nexus/sales tax exposure identified and quantified.
- Transfer pricing issues and any open IRS or state audits disclosed upfront.

## Legal & Contracts

- Customer/supplier contracts reviewed for change-of-control provisions.
- Cap table clean. Any pending litigation disclosed and quantified.

## Operations

- Key employee agreements in place.
- IP ownership confirmed and protected.
- Owner-dependency minimized: document your processes so value survives without you.

**Golden Rule: Find it before the buyer does. Every surprise = price reduction.**





# Net Working Capital

Protecting Your Purchase Price at Closing

# Net Working Capital (NWC)

## What is Net Working Capital?

- Current Assets minus Current Liabilities needed to operate the business day-to-day.
- Typically: Accounts Receivable + Inventory + Prepaids - Accounts Payable - Accrued Liabilities.

## Why Buyers Focus on NWC

- Buyers want to receive a business with enough capital to operate from Day 1 without injecting cash.
- They negotiate an NWC "target" – usually the trailing 12-month average. This is set at LOI stage.

## The Adjustment Mechanism

- Actual NWC at closing is compared to the agreed target.
- Actual > Target: seller receives more. Actual < Target: seller receives less.
- Adjustments are dollar-for-dollar changes to the purchase price. Hundreds of thousands at stake.

## Common Seller Mistakes

- Draining cash or collecting receivables aggressively pre-close (creates a NWC shortfall at closing).
- Not understanding what is included in the NWC peg definition – it matters enormously.
- Failing to negotiate the NWC target early. Once set, it is very hard to move.

## The Takeaway

- Understand your normal NWC level 12 months before you sell. Model multiple closing date scenarios.



# M&A Deal Structures

Asset vs. Equity Sales | Tax Impact | Buyer-Seller Dynamics



# M&A Deal Structures - Overview

## Two Primary Structures

- Asset Sale: Buyer acquires individual assets and liabilities. Most common buyer preference.
- Equity Sale: Buyer acquires ownership (shares). Simpler, but no step-up in basis. Preferred by sellers.

## Tax Impact to Seller

- Asset Sale: Mix of ordinary income (depreciation recapture) and capital gains. More complex return.
- Equity Sale: Generally, all capital gain. Lower effective tax rate. The seller-preferred structure.

## Tax Impact to Buyer

- Asset Sale: Stepped-up basis in acquired assets allows immediate depreciation – the buyer-preferred structure.
- Equity Sale: Buyer inherits historical (carryover) basis. No immediate depreciation benefit.

## Risk Transfer

- Asset Sale: Buyer generally does not inherit pre-closing liabilities. Lower buyer risk.
- Equity Sale: Buyer inherits all pre-closing liabilities and contingencies. R&W insurance often required.

## Bridging the Gap

- Price differential (buyer premium) often compensates sellers for accepting asset deal economics.
- Hybrid structures – 338(h)(10) elections and F Reorganizations

# Asset Sale vs. Equity Sale



## Asset Sale

### Seller Impact:

Mix of ordinary income (recapture) and capital gains. More complex tax return.

### Buyer Impact:

Stepped-up basis in acquired assets. Immediate depreciation. Preferred structure for most buyers.

### Risk Transfer:

Buyer does not inherit pre-closing liabilities (generally). Lower buyer risk.

## Equity Sale

### Seller Impact:

Generally, all capital gain. Simpler. Lower effective tax rate. Preferred by most sellers. (Partnerships will impact this)

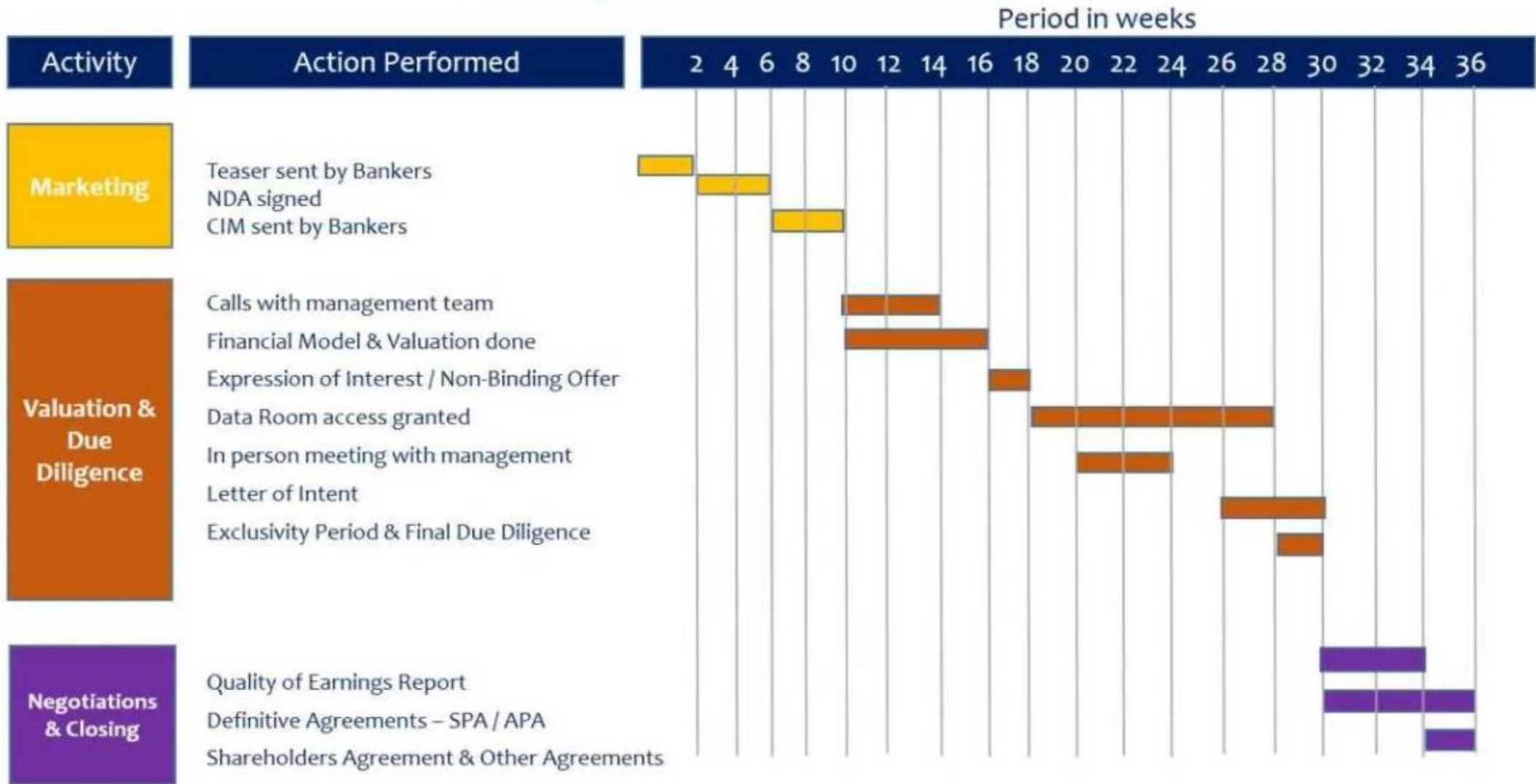
### Buyer Impact:

Inherits historical tax basis. No immediate depreciation. Often lower purchase price.

### Risk Transfer:

Buyer inherits all pre-closing liabilities and contingencies. Reps & warranties insurance often required.

# Private Equity Transaction Timeline



Source: Corporate Finance Institute



# F Reorganization

S-Corp Strategy | Pre-Sale Planning | Extremely Common Structuring

# F Reorganization – What it is

## The Conflict: Buyer wants aspects of both an Asset and Equity Sale

- Most buyers (especially PE) want an asset purchase for the step-up in basis and immediate depreciation.
- But they also don't want to renegotiate contracts, lose the entity EIN, etc.
- The F reorganization helps bridge the gap.....for Buyer.
- Maybe for Seller too.....purchase price allocation is key negotiation for seller.

## What Is an F Reorganization?

- Defined under IRC Section 368(a)(1)(F): a "mere change in identity, form, or place of organization."
- Converts an S corporation into a structure where the buyer can achieve an asset purchase economically...
- ...while the seller receives stock sale tax treatment. Both parties get what they want.

## The Mechanics — Step by Step

1. S-Corp shareholders form a new S-Corp holding company (NewCo).
2. Original S-Corp contributes its assets/operations down to a wholly-owned LLC subsidiary.
3. NewCo now owns the LLC (the operating entity), which is a disregarded entity for tax purposes.
4. Buyer purchases the LLC — treated as an asset purchase with full step-up in basis.

# F Reorganization – Why It Matters

## Tax Benefit to the Buyer

- Allows purchase of equity but treated like asset purchase.
- Full stepped-up basis in all acquired assets – goodwill amortized over 15 years.
- Immediate depreciation on equipment, real estate, and other hard assets.
- Significantly improves after-tax returns for PE funds – often worth millions.

## Why Private Equity Loves This Structure

- PE funds are return-driven. Tax efficiency is built into their underwriting models.
- Business EIN stays alive post closing.
- Allows for tax deferred equity roll-overs to Sellers
- “Bad” S election or S corp taint risk stays with Seller
- Has become standard practice in PE acquisitions of S-corps.

## Important Caveats

- Asset sale treatment to Seller.
- Must be planned and completed BEFORE the sale closes – cannot be done retroactively.
- Requires additional time and steps before closing.
- Not available for C corporations.
- State tax treatment may vary. Always requires qualified tax and legal counsel.

# F Re-Org

BEFORE

Shareholders

Op Co Inc.  
S - Corp

AFTER

Shareholders

Hold Co Inc.  
S - Corp

Op Co LLC  
DRE - LLC





# Qualified Small Business Stock

Section 1202 | Tax Exclusions | Planning Strategies

## What is QSBS?

- Section 1202 stock in a domestic C corporation issued after August 10, 1993.
- Held more than 5 years: potential exclusion from capital gains tax.

## Exclusion Rates by Issuance Date

- Issued before 9/28/2010: 50% or 75% exclusion (AMT addback may apply)
- Issued after 9/28/2010: 100% exclusion from capital gains
- Issued after 7/4/2025: partial benefits even before 5-year mark (3yr=50%, 4yr=75%)

## Exclusion Limits

- Greater of \$10M (\$15M post-7/4/25) or 10x original stock basis per taxpayer.
- Husband and wife may each have their own limitation (currently ambiguous).

## Big Picture

- A \$10M gain that qualifies = \$0 federal capital gains tax. One of the most powerful tax benefits available to startup and growth company investors.

# QSBS – Qualification Requirements

## The C Corporation Requirement

- Must be a C corp for "substantially all" of its existence.
- LLC conversion to C corp creates originally-issued stock on conversion date (need a valuation).

## Asset Test

- Less than \$50M in assets (\$75M post-7/4/25) at time stock is issued.
- Value = cash plus adjusted basis of other assets.

## 80% Active Business Rule

- At least 80% of corporate assets must be used in active conduct of a qualified trade or business while the investor holds the stock.

## Qualified Trades or Businesses

- Any business EXCEPT: health, law, accounting, consulting, financial services, hospitality, agriculture, and certain other service or natural resource industries.

## Shareholder Requirements

- Must be acquired at original issue directly from the corporation for cash, property, or services.
- Non-corporate shareholders only: individuals, partnerships, trusts, and estates.

# QSBS — PLANNING STRATEGIES



## **Gifting to Multiply Benefits**

- Transfers by gift preserve QSBS status — unlike most tax attributes.
- Gifting shares to family members can effectively multiply the exclusion across multiple taxpayers.

## **Section 1045 Rollover**

- If QSBS is sold after 6+ months, gain can be deferred by purchasing replacement QSBS within 60 days.
- Similar to a 1031 exchange. Allows the 5-year holding clock to continue ticking.

## **Partnership Issues**

- Stock contributed TO a partnership loses QSBS status.
- Stock acquired directly BY a partnership may qualify. Partners must own interests from acquisition date forward.

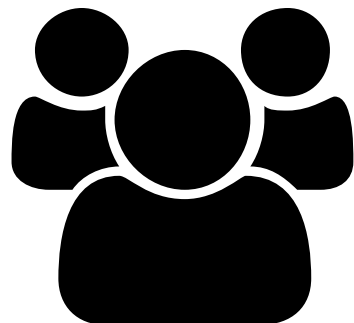
## **Section 1244 Losses — The Silver Lining**

- If QSBS fails, Section 1244 allows ordinary loss treatment (up to \$50K single / \$100K MFJ).
- Avoids the capital loss limitation. Must be original investor in a qualifying small business corp.

# Key Takeaways

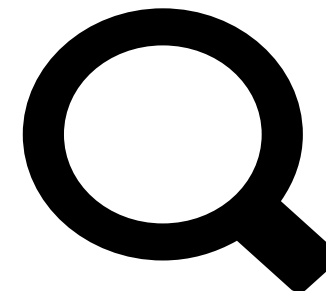
1

Start early. The best M&A outcomes are built 12-24 months before a sale, not the week you decide to sell.



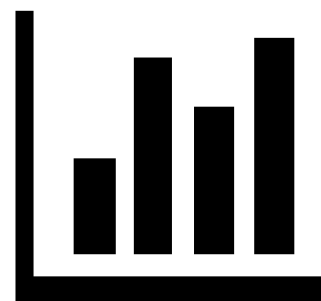
3

Know your numbers. Clean financials, normalized EBITDA, and a clear NWC story put you in control of the process.



2

Find surprises first. Seller-side diligence is the difference between a smooth close and a price chipped deal. early.



4

Structure matters. How your deal is structured can be worth millions in after-tax proceeds — get qualified advisors.



# QUESTIONS?

Erik Schumacher, CPA | 616.975.4100 | [erik.Schumacher@rehmann.com](mailto:erik.Schumacher@rehmann.com) | [Rehmann.com](http://Rehmann.com)

**Rehmann**