

M&A Nuggets: Be Prepared ... for Due Diligence, Before You Seek to Sell Part 1 – Sales Tax

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The due diligence process, during which the purchaser requests and analyzes large volumes of information, requires a huge time commitment from the sellers' personnel. Unknown issues and issues which are known but have not been dealt with in the past, can rear their head during the due diligence process, interrupt the otherwise smooth flow of information exchange and, in turn, cause unnecessary pauses and extensions of the deal. To avoid this, it is wise to address these issues prior to seeking to sell the business.

Routine items that are easily buttoned down before negotiations begin include making sure corporate documents are in place, that employment policies are up to date and that intellectual property, such as trademarks, have been properly protected. Other issues are not so routine. This article will focus one of those more unusual, or less thought of, issues – sales tax.

The issue is – has the business properly collected, paid and reported all required sales tax. Unfortunately, this issue often arises for the first time during the due diligence process, when the purchaser asks about it. Many states have expanded the application of their sales tax statutes to more and more activities, particularly services, and to more ways that products or services are delivered, particularly on-line and out-of-state sales. Many sellers are surprised to learn during the due diligence process that sales tax had not been properly accounted for. The sales tax number not accounted for, when added to interest and potential penalties owed to state governments, can be a significant number and could result in part of the purchase price being held back at closing. This all can be avoided by conducting a sales tax analysis prior to entering into negotiations. The following questions should be answered: 1) which services and products the company provides are subject to sales tax, 2) are the means by which the company provides the services and products (on-line sales, shipments out-of-state) taxable, and 3) are any of the company's customers (nonprofits, for example) are exempt from the payment of sales tax. The sales tax analysis can be laborious, given that the laws vary state by state. However, being up to speed on the issue and ensuring that the company is in compliance beforehand can save a lot of time, money and worry during the negotiation process. Look for the next issue – change of control provisions.