



Mary Hanson

About the Business Advisor

The Business Advisor is written and published by Mary Hanson, a business attorney in Torrance, California.

Mary Hanson has a law degree from the University of Wisconsin and an MBA from the University of Southern California. She has practiced business law exclusively for more than 40 years.

She provides legal services related to owning, operating, buying, selling, and structuring businesses. Her clients are business owners in many different industries. She handles corporations, LLCs, new businesses, new ventures, and a broad range of contracts and business decision-making.

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CLOSING A BUSINESS

by Mary Hanson

Businesses unable to adapt to the unprecedented challenges presented by Covid-19 may be forced to consider closing their doors.

The closure of a business is stressful, challenging, time-consuming, and expensive.

Planning for closing a business is as important as planning for starting a business. Business owners and managers facing potential closure are well advised to begin collecting the information needed to close out a business as soon as possible.

The starting point for closing or transferring ownership of a business in a challenging business environment, is to identify all the information needed to make the important decisions and create a plan for disposition of assets and resolution of obligations.

Early gathering of information and planning is essential to meet key objectives, such as:

- Reducing and resolving liabilities arising from prior operations of the business;
- Reducing and resolving liabilities arising from closure of the business;
- Getting the most value from the business assets; and
- Avoiding the stress and financial distress of forced actions.

Once a business is closed or ownership is transferred there is no second chance to do it right or to fix mistakes that have been made. The options and alternatives for making the most (and avoiding the worst) in closing a

business should be addressed prior to taking the first steps.

In fact, no steps should be taken until the most important components of liability and of value have been identified and actions have been planned to resolve, address, and dispose of the liabilities and assets. The actions planned should be consistent with the objectives of the business owners and with the other actions to be taken. All contracts, debts, obligations, necessary expenses, as well as tangible and intangible assets of value must be considered in order to address conflicting objectives and various priorities.

The alternative of selling a business or any part of it as an on-going business, rather than closing it, has many advantages over closure. A buyer of a business or part of a business will not only acquire a number of assets in one transaction but will intentionally or unintentionally take over or reduce many liabilities by continuing the activities and meeting the obligations related to the on-going business.

Typical Liabilities

Here's a list of typical liabilities a business might need to address in closing or transferring a business:

Lease for business premises. Any plans for the closure of a business operating in leased premises must consider the terms of the lease. It is important to know when the lease expires, what the total liability is under the lease, and whether the lease can be extended.

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Equipment leases. The final payment date for each lease and the total amount of all payments – or the payoff amount from the lessor or lender – is required to determine the total liability for equipment leases in the event of a transfer or closure of the business. It may be necessary to contact leasing firms to determine the options available for the transfer of leases or return of equipment. A full payoff may be necessary to transfer or close out a lease if a lessor or lender will not negotiate a lower payoff amount or permit a transfer of the lease.

Software licenses. Software has become an important component of many businesses. These licenses, like equipment leases, may not be easily terminated or transferred. A closure plan needs to consider the expiration of the current license, the terms for renewal or non-renewal, and the total cost to continue each license. Financial software may be needed long after the business is transferred or closed.

Contractual obligations. All on-going obligations must be considered. Customer contracts must be reviewed to determine what products or services the business is obligated to provide and over what period of time. Contract terms need to be reviewed to determine whether contracts can be transferred to a buyer or to another party to complete work in progress or other contractual obligations. In addition to addressing the need to complete work in progress and fulfill obligations to provide goods or services, it is important to determine whether any contracts have created long-term obligations, such as warranty coverage for products or services, that continue after the

business is no longer able to fulfill such commitments.

Agreements with vendors, consulting firms, outside professional advisors, independent contractors, distributors, and others must be reviewed for on-going payment obligations, old payment obligations, termination requirements, and the remaining contract obligations.

It may be necessary to review various sources of information to identify all the obligations, commitments, and assets to be addressed. Checking account and banking information is typically a key resource for identifying sources of income and elements of obligation, since every entry of a payment received or payment made in a checking account program reflects either a one-time or an on-going business relationship. Reviewing payment information for more than a year will also pick up infrequent but potentially large obligations such as insurance premiums and taxes.

Debt obligations. A business may have a bank line of credit and debt financing from various sources, as well as equipment loans, SBA loans, PPP loans related to a Covid-19 shutdown, and credit card balances. Each obligation needs to be identified. If a business’s loan information is not up-to-date, payoff information must be obtained from the lender. Many such loans are secured (collateralized) with assets of the business, and lenders file financing statements (UCC-1s) with state agencies to record their security interests in assets. A buyer of assets will check public records for filings with the state agency (the Secretary of State in California) and will require that the filings be terminated before the buyer will

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purchase the assets affected. Business owners need to plan to pay off or resolve loans and get the filings terminated to be able to transfer assets to buyers. Public records may contain outdated or erroneous information that must be corrected. Planning ahead allows time to resolve debt issues and negotiate payment terms or lower payoff amounts.

Insurance policies. It is also important for businesses to review insurance policies to determine whether insurance coverage is appropriate for the current operations of the business, and also to plan for any transfer or closure of the business. If a business has changed its products or services as a result of the current business environment, insurance should have been changed to cover new business risks or reflect the new level of business activity. The amount of some insurance coverage may be outdated if sales revenue and payroll numbers are reduced. It may be appropriate to drop insurance policies covering assets no longer owned or business activities in which the business is no longer engaged.

Business owners need to obtain information regarding post-closing insurance coverage from the insurance carriers providing coverage of the on-going business. Service businesses and businesses that produce or sell goods have different types of policies and different policy options for covering claims made after closure of the business based on activities or product sales when the business was in operation. A plan for closure or transfer of a business should include a plan for obtaining post-closure (or post-transfer) insurance coverage.

If the business or a portion of it will be transferred to a buyer, the buyer will want to know that appropriate insurance coverage is in place until the buyer takes possession of the business, at which point the buyer's insurance must cover the business.

Payroll and employee termination.

When a business is sold or closed employees are terminated and the business must comply with state and federal laws regarding termination of employees. Businesses that meet certain levels must give advance notice of closure or layoff. Any termination requires compliance with the requirements for prompt payment of final wages and other compensation. Failure to comply with requirements can unnecessarily increase a business's closure liability. A business that has "issues" with employees needs advice from an employment attorney regarding potential employee claims, as well as compliance related to the termination of employment..

Taxes. A closure plan requires an estimate of tax liability for the year the business is sold or closed. Taxes are likely to be very different from prior years and the assistance of a business's tax advisor may be essential to capture all tax aspects of the closure of the business. In addition to the usual state and local income taxes, the business may owe taxes on capital gains, depreciation recapture, and other aspects of the sale of assets.

A business that does not have a sales tax permit and normally does not collect sales tax may become subject to sales tax on the sale of assets if assets are sold in several sales rather than in one sale to one buyer or in an auction.



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Publisher's Note

Every closure of a business involves one or more sales. Effort should be made to find a business willing to purchase some or all of a closing business's assets. Even if a buyer is unable or unwilling to pay much for business assets, a successor business serves the need to dispose of assets, and also reduces liabilities by employing employees, assuming leases for space or equipment, and fulfilling contract obligations that would otherwise be liabilities for the closing business.

Business owners forced to consider closing a business face a huge amount of "homework" in gathering and reviewing their business information. In addition, it is essential that they get information and advice from outside advisers early in the process. Tax advice should be obtained at the earliest stages of considering a closure or sale, since the closure of a business involves a wide range of financial activity that affects taxes, often in ways that are not obvious. Other sources of key advice are insurance brokers, employment attorneys, and firms that sell businesses or sell assets. If bankruptcy ought to be considered or advice is needed regarding liens, loans, collateral, lenders, debt negotiation, and repayment plans, early advice from a business bankruptcy attorney is recommended.

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Personal liability. In the review of all obligations, business owners will want to determine whether they have personal liability arising either by law or from the terms of contracts signed. Personal guarantees are often signed for leases, bank lines of credit, credit cards, and vendor contracts. State laws impose personal liability on business owners for some unpaid taxes.

Personal funding. A corporate shareholder or business partner providing personal funds for business purposes should document the use of such funds. Whether the funds are treated as a shareholder loan, additional capital, or some other arrangement, documenting the amount and the use of the funds is important for the individual to get any repayment or tax benefit from the use of personal funds.

Assets

Business owners and managers need a plan for disposing of physical assets (furniture, computer equipment, machinery, tools, and supplies) as well as intangible assets, such as customer lists, customer information, trade names, website domain names, trademarks, websites, and intellectual property.

A good plan identifies assets with the highest value and prioritizes getting value from the disposition of those assets. It also prioritizes the disposition of assets with associated liabilities that would be resolved by the transfer of the assets.

There is no easy option of "closing the doors" or "liquidating" the business that avoids liability. Only good planning and well-considered steps will reduce liability while maximizing the value of assets sold.

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