# MurphyAustin



#### So You Want To Buy/Sell a Business? By Jeffrey W. Curcio, Esq.

## Introduction

If you are considering buying or selling a business, it is essential to understand the key legal issues that define and shape the outcome of this type of transaction. Along with legal counsel, parties need guidance in many areas, including accounting, insurance, estate planning and tax issues. Business owners and purchasers can ensure the process goes smoothly by crafting a precise letter of intent, following a thorough due diligence checklist, creating solid agreements, and closing effectively.

## The Letter of Intent (LOI)

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The letter of intent functions as an expression of all parties' intent and serves as a road map for developing definitive agreements. The letter of intent often includes both binding and nonbinding provisions:

#### **Examples of Binding Provisions**

- Confidentiality of proposed transaction and • information/documents provided.
- Non-solicitation of customers and employees.
- Exclusivity ("no shop"), i.e., no other sale • attempts during pre-agreed period of time.
- Deposit: refundable if Seller fails to close; not refundable if Buyer fails to close without cause; credited against price if closes.

#### **Nonbinding Provisions**

- Structure (asset sale, stock sale, merger, etc.).
- Price and terms of payment.
- Covenant not to compete.
- Role of seller post-closing (employee, consultant, included transitional assistance, etc.).
- Representations ("Reps") & Warranties.

Parties must be careful to avoid, by their statements and conduct, unintentionally converting a non-binding LOI into a binding contract.

# **Due Diligence Process**

A potential buyer will want to learn about the business. Topics to investigate include: corporate or other formation/organizational documents; ownership information; tangible assets; financial information, including debt structure; leasing and other contractual arrangements; employees and the compensation arrangements; intellectual property; pending or threatened litigation or disputes; insurances; governmental/regulatory issues; etc.

#### A Due Diligence Checklist is available at http://www.murphyaustin.com/media/k2/attachments/ Due\_Diligence\_Request\_List.pdf

The issues involved in a business acquisition, as well as the scope of the due diligence process, depend on the nature of the parties.

A Comparison of Business Entities memo is also available at http://www.murphyaustin.com/media/k2/ attachments/Comparison of Business Entities.pdf reflecting tax and non-tax attributes.

## **Definitive Agreements**



The binding contract and related documents are

referred to as the "definitive agreements." The primary contract depends on the structure of the transaction, i.e., an asset purchase agreement, a stock purchase agreement, a reorganization agreement



General steps to ensure successful business sales or purchase transactions include a letter of intent ("LOI"), due diligence, definitive documents and a closing.

(merger or other combination type transaction), etc. Transactions generally fall into taxable and non-taxable transactions – tax implications should always be analyzed for all the parties involved.

#### Taxable

Taxable transactions include asset and stock sales. Some key elements of the definitive agreements for these transactions are shown below.

#### Sale of Assets

- Purchase price, terms and allocation of price amongst assets (Internal Revenue Code ("IRC") Section 1060).
- Liability assumption
- Representations & Warranties
- Handling of Personal Guarantees
- Post-Closing Seller Reps
- Closing
- Dispute Resolution
- Indemnity

#### Sale of Stock

- Similar provisions to asset sale.
- Generally, no purchase price allocation as to assets (exception re IRC Section 338(h) (10)and other tax elections).
- Buyer generally assumes known and unknown liabilities, but can limit exposure through Seller Reps, warranties, and indemnity.

#### Examples of Tax Aspects

- "Double tax" exposure re "C" corporations— in an asset sale, a normal corporation is taxed on any realized gain, then the shareholders are again taxed on the liquidating distribution of the net proceeds.
- Covenant not to compete ordinary income to covenator, and 15 year amortizable asset for buyer.
- "Personal Good Will" the potential to identify the intangible asset "goodwill" as owned by one or more shareholders as opposed to the corporation itself.
- Seller Consulting/Employment as ordinary income.

#### Non-taxable

The parties may desire a non-taxable structure to the acquisition, particulary where the owners of the acquired

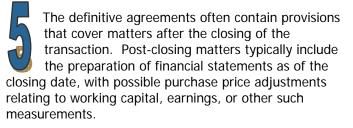
company intend to continue with the acquiror. The general types of non-taxable transactions are shown below:

- Merger §IRC 368(a)(1)(A) a "target corporation" is merged into the "surviving corporation."
- "Stock for Stock" §IRC 368(a)(1)(B) the owners of the target corporation's stock exchange their shares for shares in the acquiring corporation.
- "Stock for Assets" §IRC 368(a)(1)(C) the owners of the target corporation agree to the acquisition of assets for shares in the acquiring corporation.

## The Closing

The definitive agreements will indicate the conditions that must be met for, and the time and place of, closing the transaction. Closing conditions include such items as the current accuracy of the seller's representations, no material adverse changes in the condition of the target entity, legal opinions, and successful financing. An effective closing requires cooperation and coordination by the parties and their teams of professional advisors to ensure a successful conclusion.

## Post-Closing



## Conclusion

Legal guidance is crucial in addressing the complexities involved in a business acquisition or combination. While the parties are generally best suited to negotiating the business terms of a transaction, early involvement of counsel will ensure a more thorough investigation and negotiation process, and the preparation of the documents to accomplish the goals of the parties.

## Murphy Austin Adams Schoenfeld LLP

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Our corporate attorneys have represented domestic and foreign buyers, sellers and investors; start-up and emerging-growth companies, technology-oriented companies; entrepreneurs; commercial lenders; institutional investors; and the shareholders, directors, and officers of private companies.



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