PURCHASE OF A BUSINESS

One of the primary decisions involved in the purchase of a business concerns the basic structure of the transaction. Various factors will influence the manner in which the transaction is to be structured, and the format will affect the legal issues, documentation, operations and tax aspects. Transactions can be structured so that the gain or loss on the sale is immediately taxed (taxable acquisitions) or deferred (nontaxable acquisitions).

If the business to be acquired is a sole proprietorship or partnership, the transaction will automatically be structured as an asset acquisition. However, the majority of businesses operate in the corporate form, and the acquisition can take one of several forms, which can be broadly categorized as follows: asset purchase, stock purchase, or merger or consolidation.

TAXABLE ACQUISITIONS

Two types of corporate acquisitions will involve immediate taxation of the event to the seller and inability to defer resulting gain or loss. These transactions most frequently involve the sale of purchase of a small to medium-sized closely held business. They are either: (1) the sale and purchase of assets, or (2) the sale and purchase of corporate stock.

SALE OF ASSETS

When assets are acquired, the purchaser buys all or specified assets of the selling entity and may assume none, some, or all of the liabilities of the business. Aside from tax considerations, an asset purchase may be more attractive to the buyer, since the buyer may be able to pick and choose the specific items desired and can attempt to avoid assuming debts and liabilities of the selling entity. An asset acquisition is also designed to reduce the buyer's exposure to possible unknown or contingent liabilities. In some cases, however, certain liabilities may follow the buyer.

In spite of the general tendency of the purchaser to prefer an asset purchase, there are some circumstances in which an asset acquisition will not be appropriate, even from the purchaser's standpoint. For example, if there are certain licenses, trademarks, leases, or various contracts which are either not assignable or difficult to assign, it may be advisable to purchase corporate stock, rather than assets. Caution must be exercised even in this situation, however, because the more sophisticated contracts, leases, and franchise agreements, etc. frequently treat a significant change in corporate stock ownership as triggering a prohibition on assignment, and approval may be required even in a corporate stock purchase transaction.

When assets are acquired, appropriate documents must be prepared in order to effectuate the transfer of title to each particular asset which is being transferred. This can involve a great deal of paper work and may require approvals and consents from various other parties, depending on the entity which is being purchased.

Certain corporate formalities must be followed in an asset transaction, by both the seller and the buyer. Approval of a majority of the board of directors of the acquiring corporation is normally required. For the acquired corporation, the transaction is usually first approved by its board of directors and then submitted to its shareholders for approval.

As previously noted, one of the major advantages of structuring the transaction as an asset purchase is the ability of the purchaser to specifically exclude certain debts and obligations of the seller. Although the parties can contract to provide that the purchaser is not liable for the seller's debts, there are several situations in which liability cannot be avoided. If the purchaser makes payment for the assets directly to the shareholders of the selling corporation, creditors might argue that the corporation was thereby stripped of all of the assets that would have been available for payment to creditors. Also, in cases where the consideration for the

acquired assets is composed of stock of the acquiring corporation, and the stock is thereafter distributed to stockholders on dissolution of the selling corporation, many courts will permit unpaid creditors to assert their claims directly against the purchasing corporation. The acquiring entity may be liable for certain types of claims, such as product liability claims, notwithstanding the fact that the transaction is structured as an asset purchase.

As illustrated above, an asset transaction will not always assure that the purchaser will not be liable for the debts of the seller. Likewise, care must be exercised so that the shareholders of the sellers involved in the transaction do not lose their protection from limited liability. The sale of assets will frequently be followed by a corporate dissolution and distribution of the consideration received in accordance with the Internal Revenue Code.

SALE OF CORPORATE STOCK

The purchaser can acquire control of another company through the acquisition of the shares of stock owned by the seller's shareholders. In this type of acquisition, control of the acquired entity is obtained through stock ownership, rather than a direct acquisition of the assets. The legal and corporate status of the acquired entity remains the same following the acquisition.

As a general rule, a purchaser would rather structure the transaction as an asset purchase, while a seller would prefer a stock acquisition. Nevertheless, concern over securities law compliance may affect the purchaser's preference. A stock purchase is easy to accomplish since numerous separate conveyances of the assets are not required, and the seller can completely separate himself from the business (except to the extent that any warranties or any obligations on which the seller might remain personally liable survive the closing).

As noted above, circumstances may arise where a stock acquisition is necessary or preferable to an asset purchase, even for the purchaser. For example, where beneficial carryover tax attributes are available, a stock transaction may be desirable for the purchaser. When favorable insurance and employment ratings can be retained, they may also be a consideration for a stock transaction to the purchaser.

Although one of the main non-tax considerations for the buyer in desiring an asset purchase is the risk of being saddled with unknown and contingent liabilities, the impact of this problem can sometimes be ameliorated by the establishment of holdback arrangements. Such arrangements typically involve escrowing of funds, rights to offset payments on seller financed promissory notes, execution of non-negotiable promissory notes to evidence seller financing, and provisions in the sale agreement in delaying the payment of the full purchase price until certain contingencies have been satisfied.

In a typical stock acquisition, the purchaser acquires the stock from the corporate shareholders in exchange for cash, notes, stock, other property, or a combination of these items. In most cases, the buyer will want to purchase the entire outstanding stock of the seller; however, there may be situations where it would be advantageous to have a minority shareholder retain an interest in the corporation being sold. For example, if a key management figure has an ownership interest in the corporation, it may be beneficial for the corporation for him to retain that interest in order to maintain continuity of management and the value of a key employee. The psychological and economic advantages of having an important employee continue to own a stake of the business, even after new ownership of the majority of stock, should be carefully weighed.

Simplicity is perhaps the key non-tax feature of a stock acquisition. Since nothing other than corporate stock of the corporation is transferred, the often cumbersome preparation and execution of documents of transfer are not necessary. Although the selling shareholders must agree to sell their corporate stock, no shareholder votes are necessary, nor are there any shareholders' dissenters' or appraisal rights. The sale of corporate stock will normally avoid sales taxes, although Florida does impose a tax on the transfer of stock.

It must be emphasized that the mechanical ease of accomplishing the actual corporate stock transfer should not lull the purchaser into believing that an investigation into the corporation is not necessary. To the contrary, the investigation should be at least as, if not more, comprehensive than one undertaken in the course of an asset transaction. It is perhaps most crucial in regard to liabilities, since the person or entity acquiring the stock faces the risk imposed by disclosed, undisclosed, fixed, contingent, and unknown liabilities. Although the entity or person which acquires the stock does not assume such liabilities personally, they nonetheless run with the corporation and will affect the assets of the business. The degree and extent of the risk associated with the transaction, and the likelihood of liabilities which have not surfaced, should have a direct bearing on the negotiated purchase price.

One thing is very clear; the acquisition of a business can provide the gateway to substantial wealth. At Spiegel & Utrera, Lawrence J. Spiegel has been involved in many business acquisitions representing buyers and sellers. You can have an immediate consultation about your possible business purchase with Larry or another qualified attorney by calling 800-603-3900 ($3.99 per minute charged to any major credit card) or 900-370-6800 ($4.99 per minute charged to your phone, you must be 18). Also, please feel free to call any Spiegel & Utrera office to arrange for an appointment to discuss your business purchase, because in every deal their are numerous topics, both legal and business, that need careful evaluation. Call us - we want to help you get wealthy!

If you have any questions, please call a Spiegel & Utrera office listed below:

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