



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)

1 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

2 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

3 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 covenantor, 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, particularly 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

4

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

5

The definitive agreements often contain provisions that cover matters after the closing of the transaction. Post-closing matters typically include the preparation of financial statements as of the closing date, with possible purchase price adjustments relating to working capital, earnings, or other such measurements.

Conclusion

6

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

Murphy Austin Adams Schoenfeld LLP, a premier law firm in the Sacramento region, is committed to client service and professional excellence. We value our long-standing relationships with our many exceptional clients as the highest form of professional compliment.

The firm focuses on the core areas of business and real estate transactions, healthcare, construction, labor and employment law, tax, and commercial litigation.

We take pride in the expertise and experience of our attorneys. Every partner brings years of experience in practicing law in his or her area of expertise. Our attorneys have practiced in a wide variety of state and federal administrative settings, in the California state trial and appellate courts, and in the United States District Courts, Court of Appeals, and Supreme Court. Although most of the firm's clients have legal needs primarily in the greater Sacramento region, our attorneys regularly represent client interests throughout California and in other states.

Our attorneys have taught as university faculty and frequently speak at national, regional and local conventions and meetings in their areas of expertise. Many of our attorneys regularly publish in the trade publications widely distributed in the industries that they serve.

Corporate and Business Law Team

Our Corporate and Business Law Team focuses on private securities offerings, mergers and acquisitions, financings of emerging-growth companies and other corporate finance transactions, as well as general corporate and securities counseling of privately held companies. Our corporate and securities transactions range from the organization and financing of small, start-up ventures to high-profile, complex transactions.

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.



Jeffrey W. Curcio, Esq.

jcurcio@murphyaustin.com
916-446-2300 X3024

Jeff Curcio is a partner with Murphy Austin's Corporate and Business and Tax Law practice teams.

MurphyAustin
ATTORNEYS

Murphy Austin Adams Schoenfeld LLP
555 Capitol Mall, Suite 850
Sacramento, CA 95814
916/446-2300
Facsimile: 916/503-4000
murphyaustin.com

Please be assured that we make every effort to make certain that the information contained in this article is current at the time the article was prepared. Because laws and legislation are constantly changing, please contact us if you are unsure whether this material is still current. Nothing contained herein is meant to be legal advice. Please contact us to answer any questions you may have.