

## **Key Issues To Consider When Purchasing A Business**

**By Richard J. Shapiro, J.D.**

Even in a troubled economy, there will always be those risk takers having the passion and conviction to own and operate their own business. Some will start a business from scratch; others will prefer purchasing an established business.

If you are considering purchasing an existing business, it is critical that you conduct a “due diligence review” to ensure that you have all the relevant information needed to evaluate the associated risks and likely rewards. The due diligence review will encompass such issues as:

- A market analysis of the ongoing demand for the business’s products or service
- An evaluation of the capabilities of the existing employees, and whether additional employees will be required
- A review of the suitability of existing equipment and facilities
- A detailed review of the company’s books (to be performed by an experienced accountant) to ensure that the purchase price is fair and reasonable
- A legal review that will include items such as (i) analysis of the company’s organization documents such as bylaws, operating agreements, shareholder agreements, stock records and partnership agreements; (ii) review of the company’s contracts and leases with third parties; (iii) a search of county and state records for liens, judgments and other public records affecting the company and its current owners; (iv) a review of any trademarks or copyrights being transferred; (v) analysis of any employment contracts and union agreements; and (vi) a review of the company’s retirement plans to ensure adequate funding and record management

In conducting the due diligence review, the seller, purchaser, and their respective representatives should sign a confidentiality and non-disclosure agreement protecting confidential information associated with the transaction.

A significant issue is whether the sale will be structured as an “asset sale,” or rather as the sale of the company stock or limited liability company membership interests, as applicable. In most cases the purchaser will prefer to acquire the company’s assets rather than the seller’s stock or other ownership interest. If you purchase the seller’s stock, then you will be acquiring not only the company’s underlying assets, but also the company’s liabilities. With a stock sale, the purchaser will also forfeit potentially favorable tax advantages achieved through allocation of the purchase price among various asset types.

Either during or at the conclusion of the due diligence period, the parties will need to formalize their agreement in a contract of sale. The contract will incorporate a number of standard provisions, including:

- the purchase price and the amount of the down payment
- whether the purchaser will be purchasing only business assets, or the seller's stock or LLC membership interests
- the amount to be financed, including the terms of any seller financing and collateral to be used as security
- the allocation of purchase price among the various asset classes (i.e., real estate, machinery, goodwill, leasehold, covenant not to compete, inventory, etc.)
- the extent to which the purchaser will assume the seller's liabilities
- representations and warranties for both seller and purchaser
- the closing date
- a list of assets to be conveyed
- a statement of any existing or pending litigation for either party
- any conditions to closing, such as governmental or bank approvals
- the seller's agreement to indemnify the purchaser against any unassumed liabilities

After the contract is signed, the purchaser will need to complete any remaining due diligence items. If the purchaser is acquiring real estate as part of the deal, he will need to have a title search performed to ensure he is acquiring clear title. If bank financing is being used to finance part of the purchase price, the bank will go through its own due diligence procedure. Once all pre-closing items are completed, the closing will take place. If the full purchase price is being paid at closing – either from the buyer's own funds (rarely) or through commercial financing -- the seller will walk away with the full sale proceeds at closing. More commonly, the seller will be taking back a note for a portion of the sale price.

At closing, the seller's attorney will prepare various documents that may include (1) bills of sale, (2) deeds (if real estate is part of the purchase), (3) assignments of equipment leases, (4) one or more promissory notes, (5) mortgages and security agreements, (6) employment agreements, (7) resolutions authorizing the sale of assets by the corporation or LLC, (8) equipment lists, (9) covenants not to compete, (10), assignments of phone numbers, websites, copyrights, trademarks and other intellectual property, (11) resignations of officers, (12) sales tax returns, (13) escrow agreements, (14) personal guarantees and (15) motor vehicle registrations.

If the seller is providing financing, after the closing the security agreement and UCC financing statements will be filed with the appropriate governing bodies to properly secure seller's interest in the business assets and any other collateral used to secure the purchaser's obligation to pay on the promissory note. These filings will ensure that the

seller has “first position” to reclaim any of the collateral in the event that the purchaser shall default in any payments under the promissory note(s).

Purchasing a business is a significant life event. It is essential that a prospective business purchaser retain an experienced attorney and accountant to ensure that the purchaser’s interests are fully protected during each phase of the transaction.

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