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The Process of Buying or Selling a Business

Although no two deals are exactly the same, the structure of the purchase and sale of a business will typically fall into one of three categories:

- An **asset purchase** means that a buyer will purchase the assets of the business without necessarily buying the business entity itself.

- A **stock purchase** means that you take over the business by stepping into the shoes of the existing owners.

- A **merger** refers to combining two or more existing businesses into one.

There are numerous pros and cons to each type of structure.

An **asset purchase** is sometimes the cleanest way to go. As a buyer, you could acquire most of the assets of the business generally free and clear of all liabilities, except for certain specified liabilities that buyers typically assume (e.g., remaining payments due under an equipment lease for equipment that will be transferred to the buyer). In addition, the buyer gets what is called a "**step-up**" in tax basis for the purchased assets, which usually means the buyer has more to depreciate and, thus, benefits from subsequently having a non-cash expense/deduction. The downside for the buyer, however, is that it might have to pay a transfer tax on the tangible assets that it purchases. In addition, the principals of the seller entity may prefer an asset purchase because they too could receive an upward adjustment in their tax basis (assuming the seller entity is an S-corporation). Thus, with a higher tax basis, the seller principals will incur a lower tax on the gain from the asset purchase/sale.

In contrast, a buyer agreeing to a **stock purchase** typically is held accountable for all debts and obligations of the entity being sold. For this reason alone, many buyers avoid stock purchases. However, the transition process is sometimes much easier with a stock purchase, too, because title to the business assets remain with the corporation being sold. The buyer is simply stepping into the shoes of the seller. If a buyer is interested in the seller because the seller has client contracts that are very valuable but are not transferable to the buyer (unless the client consents to the transfer), the buyer might be willing to risk the liabilities associated with the stock sale in order to obtain the legal rights to those valuable contracts (because the buyer is simply stepping into the shoes of the seller) without seeking to obtain the consent of the other party to each contract.

A **merger** between two entities usually results in a surviving entity and a non-surviving entity (i.e., the target). Thus, by operation of states' business statutes, the surviving entity assumes all the rights and obligations of the non-surviving entity (similar to a stock purchase) but the seller entity is deemed to have dissolved upon consummation of the merger (i.e., it is no longer a recognized legal entity). Mergers typically are used in public company deals, primarily because they can be structured so that the seller's owners can defer their capital gains basically by giving up their ownership interest in the non-surviving entity in exchange for an ownership interest in the surviving entity.

Depending on the size and complexity of the deal, there may be spin-offs, divestitures, or other undertakings that make it difficult to pigeonhole the transaction as an asset purchase, a stock purchase or a merger. However, most deals will progress in a similar manner:

1. Preliminary Discussions
2. Negotiating a letter of intent
3. Signing a confidentiality agreement
4. Drafting and finalizing a formal agreement
5. Undertaking due diligence
6. Seeking approval from governmental authorities and consents from third parties
7. Closing
8. Post-closing adjustments

Depending on the structure of the transaction, bringing a deal to closure could take anywhere from two months to a year or more. Without much doubt, the process will take longer than you would have expected.

As early as possible in the process, a lawyer and a financial advisor should be brought into the picture. One immediate benefit to doing so is that they may be able to help you to structure the deal to your best advantage before the transaction proceeds too far without having reviewed the potential pitfalls.

Proper representation is critical even in **preliminary discussions**. Many an unsuspecting seller has signed something while in preliminary discussions that is later regretted so common sense dictates having a lawyer on your team before you sign anything.

After the parties "shake hands" on a deal, the next step is usually to negotiate a **letter of intent**. The logic of having a letter of intent is to secure a level of commitment from the parties to show that they are serious about the deal. Otherwise, they may never get to the point of negotiating the finer points that always show up in the formal agreement. Unless you have some advantage to be gained from signing an enforceable letter of intent, it will usually be drafted as "non-binding" on its face.

As soon as possible, the other side will want access to the inner workings of your business to verify that it is everything you say it is. Before you turn over on your belly, though, you should have a **confidentiality agreement** in place to protect your interests—just in case the other side is showing interest solely to gain access to your business' confidential information (e.g., product pricing, marketing plans, etc.).

Somewhere along the line, a **formal agreement** will have to be finalized and signed. Most business deals are similar to the sale of a house in that the buyer and seller enter into a formal agreement but close the deal at a later date (the length of which depends on the contingencies). There are almost always many drafts that are negotiated and go back and forth before the final version is acceptable to the buyer and the seller. This is the point in the process where you absolutely need good legal representation because of the significant potential risks.

During (or after, depending on the circumstances) the buyer engages in the **due diligence** process by requesting to review various documents in connection with the seller's business to make sure that everything is in good order. The seller should be ready to come under more scrutiny than ever before.

Also keep in mind that the **government approval process** can be rigorous. One example is tax clearance certificates and certificates of good standing for your business entity. Sometimes, you may even need to get a governmental entity to approve a transaction before it goes forward. You will probably also need to get **consents from third parties** to assign contract rights (generally only for asset purchase deals).

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The **closing** occurs at a mutually agreed upon date and time, typically at the office of either the buyer's or the seller's legal counsel. Some closings may involve a third party escrow company (especially when real property and public notices for "bulk sales" are involved). If there is an escrow, another level of documentation and compliance with the escrow company's requirements will be involved.

Some form of **post-closing adjustments** may be involved as well. One of the terms a buyer may negotiate, for example, is a representation that the business will perform at a given volume for a certain period of time after closing. Based on what happens after the closing, the purchase price may be adjusted up or down after the closing. Other types of adjustments, primarily in an asset purchase, include amounts for certain expenses that the seller has pre-paid but are for periods after the closing (e.g., pro-rating the monthly rent for the business premises).

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