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## **BUSINESS SALE CONCEPTS, ISSUES, TRAPS & TOOLS SEMINAR**

### **A. The Two Types of Business Sales and When Each Is Used.**

1. Asset Purchase. This is the most common way to purchase small businesses. It is strongly desired by Buyers because it avoids Buyers unknowingly assuming the liabilities of the entity (e.g., a corporation or limited liability company -- "LLC") that owns the business, which liabilities were not disclosed by, or were even unknown to, the Seller. These liabilities are avoided because the business and all business assets are purchased, but the entity owning the business and assets is not, which entity remains responsible for the liabilities. The entity is actually left in the hands of the Seller, the only change usually being to the entity's name, if the name of the entity was also the trade name of the business and the Seller had agreed to sell the trade name to the Buyer.

2. Stock Purchase.

a. Despite the liability pitfall discussed above, the stock purchase is the preferred way to purchase large businesses owned by corporations whose stocks are publicly traded on the stock markets. It is simply too cumbersome to purchase the assets of the businesses individually, so a controlling interest in the corporation's stock is purchased, which in turn gives the Buyer control of the corporate entity, which in turn gives the Buyer control over the business and its assets. The stock purchase is also used in small businesses where the Seller has negotiating leverage and perhaps has a larger tax basis for capital gains tax purposes in the stock than the Seller does in the business and its assets. Also, a stock purchase is used when the Buyer is buying out one or more owners of the business, but not all of them.

b. In a stock purchase transaction, the stock has to be valued to determine the price to be paid, but the stock's value is based upon the value of the business and its

assets. Therefore, the value of the business and its assets plus the business's revenues, expenses, and liabilities must also be verified to ensure the stock is worth what it is thought to be worth. Thus, all of the inspections and due diligence that must be completed, and all the issues and deal points discussed below that must be considered, in an asset purchase also apply to a stock purchase, since, again, the value of the business and its assets creates the value of the stock.

## **B. Entities Used to Purchase Businesses.**

1. LLCs. Limited liability companies are rapidly overtaking S Corporations as the preferred entity to purchase a small business, particularly if the business includes real property. Both corporations and LLCs provide the Buyer with its main objective, which is to limit the Buyer's personal liability to pay the debts and liabilities of the business if they exceed the business's ability to pay. Thus, in general, business creditors cannot seize the Buyer's personal assets to pay business debts or liabilities. Like S Corporations, LLCs do not have to pay federal or state income taxes, although they have to file "information returns" to disclose to the IRS the owners of the entity, because the owners are obligated to pay personal income taxes on their share of income to which they are entitled from those entities, even if those entities do not distribute that income. Unlike S Corporations, LLCs have almost all of the income tax advantages that a general partnership or a sole proprietorship has, these entities having the maximum income tax advantages of all entities.

2. Corporations. If the business has no real property, S Corporations can still be used, have most of the tax advantages that LLCs have for these businesses, and cost less to form. S Corporations are corporations that cannot have more than 75 shareholders, none of whom may be foreign citizens. If a large business is being purchased, whether by asset or stock purchase, normal C Corporations are still the entity of choice since they can have unlimited shareholders of every nationality, which is important if large sums of capital need to be raised from investors. Further, most large businesses have to be purchased through a stock purchase, since an asset purchase, which would require listing and purchasing every single asset in every office, plant, and warehouse of the business, would be far too cumbersome a process. C Corporations, however, have to pay income tax on their profits, and when they distribute all or part of those profits as dividends, the owners, or shareholders, also have to pay income tax on those dividends. Thus, profits distributed from C Corporations are taxed twice, unlike profits distributed by S Corporations, which are taxed only once, at the shareholder level.

3. Sole Proprietorships and Partnerships. If the conducting of a business does not carry much risk, e.g., a mail order business out of one's home, a sole proprietorship is fine, because, although it does not protect one from personal liability to third parties, the risk is probably low to begin with. Also, a sole proprietorship may be necessary if the owner cannot afford to form a corporation or LLC. If the "sole proprietorship" is owned by more than one person, it automatically becomes a general partnership, which also does not provide any personal liability protection, but is sometimes used when the risk is low or the owners cannot afford to form a corporation or LLC. As mentioned above, sole

proprietorships and general partnerships have the maximum income tax advantages of all of the entities discussed.

**C. Valuing Businesses.** In determining the purchase price to be paid, all of the following should be considered: (1) the fair market value of the business assets, less business debt and liabilities, (2) the present value of the profits being earned, and (3) the potential for growth in future profits. However, revenues less the expenses of the business should yield enough profit for *all three* of the following: (1) making the payments on the loan used to purchase the business, (2) providing a reasonable salary to the owners for the amount of time and expertise that they provide to the business, and (3) providing a yield of 10%-20% on the money used to purchase the business. Otherwise, if the business cannot provide the new owners with reasonable salaries for their time, experience, and effort, together with a reasonable return on their personal monies invested, they would be better off to avoid the risk and stress involved in purchasing and operating a business, and simply find a job providing the same salary, while investing their personal funds in stocks, bonds, or other investments. *Note:* if the business has specific inventory or supplies, these items should be purchased separately from the other assets, and their purchase price should be determined by the number of inventory or supply items (limited by a maximum number to be purchased, lest the Seller overstock inventory, and by a minimum number to be sold, lest the Seller under-supply the inventory, prior to closing) multiplied by each item's net invoice cost to the Seller.

**D. The Need for a Buyer to Have a Business Budget.** As a part of the Buyer's decision on whether to buy a business or not, it should be stressed to the Buyer that the Buyer must create two business budgets – one for the short-term and one for the long-term.

1. Short-Term Budget. The purpose of the short-term budget is to ensure that the Buyer will have enough owner funds and borrowed funds to:

a. Purchase the business; and

b. Cover expenses until revenues start being received, since expenses always have to be incurred first in order to provide the products and services that in turn generate the revenues. These expenses include labor costs, material costs, advertising, rent or mortgage payments, utilities, insurance, etc.

If the Buyer does not have sufficient funds, the Buyer must not purchase the business.

2. Long-Term Budget. The first purpose of the long-term budget is to ensure that, once revenues reach anticipated levels, they will be enough to cover all expenses, provide the owners with salaries, and provide them with a return on the monies they invested in purchasing the business. If this is not the case, the Buyer should not buy the business. The second purpose of the long-term budget is to set goals and limits for revenues and expenses for the business. The business owner can then monitor actual revenues and expenses against the goals and limits to detect problems and try to remedy them with, for example, more or different marketing to increase revenues, better quality controls to

avoid dissatisfied customers and stop the wasting of labor and/or materials, and better costs controls to limit expenses to their approved budgetary levels.

**E. When and How to Buy Accounts Receivable.** A Buyer should almost never buy accounts receivable for the following reasons: (1) everything has to go right and nothing can go wrong in order for a Buyer to collect all of the accounts receivable the Buyer purchased from the Seller, (2) the purchase of accounts receivable absorbs much needed initial working capital that the Buyer could far more usefully apply to other costs and expenses, and (3) in small businesses, some customers have the misconception that since the Buyer as the current owner did not provide the goods and services to them, which the account receivable represents, they do not have to pay the Buyer for the accounts receivable, even if the Buyer has proof that it purchased the accounts receivable from the Seller. Therefore, a Buyer should only buy accounts receivable from a Seller if the Seller insists and/or the Buyer is able to purchase the accounts receivable at a discount, and we do not mean a 10% discount: it should be a 25%, 33 $\frac{1}{3}$ %, 50%, 60%, or even 75% or 80% discount, depending upon the age of the accounts receivable, some of which may be so old as to have no value.

**F. The Need for an Inspection Period and What to Do During It.**

1. Caveat Emptor. In the purchase of a business, *caveat emptor*, which means “let the buyer beware,” is basically the controlling principle and law of Florida. Sellers do not have to make any representations or warranties, and there are far more risks and unknown liabilities involved in the purchase of a business as compared to real property of an equal value.

2. The Inspection Period. Therefore, given the preceding risks, in standard business contracts, it is normal for a Buyer to have an inspection or due diligence period in which a Buyer can examine the business’s assets, books, and records to determine if the Buyer wishes to go forward with the transaction in the Buyer’s sole discretion. If, during the inspection period, the Buyer decides not to go forward with the transaction, the contract terminates, and the Buyer typically receives a full refund of any deposit(s).

3. Items Inspected. All accounting and tax records should be reviewed by the Buyer or the Buyer’s accountant in order to verify the business’s revenues, expenses, and cash flows and to ensure that all previous tax returns and taxes owed to state and federal authorities have been filed and paid. At this point, any lease for the business premises is reviewed for the issues discussed below. Any employment agreements should be reviewed. Contracts with business customers and vendors should be reviewed for their financial strengths and weaknesses. Any inventory should be inspected to determine that it is current and saleable. Equipment, furniture, and furnishings should be inspected to ensure their presence, operating condition, and value. Accrued employee benefits should be determined and either paid to the employees by the Seller, or, if such benefits will continue to be provided by the Buyer, the value of such accrued benefits should be paid to the Buyer by the Seller. Finally, if the Seller is not financing the purchase of the business, the Buyer should use the inspection period to ensure that it can obtain all

necessary financing upon acceptable terms and conditions. Both the Seller and the Buyer should realize that the Buyer's right to cancel the contract during the inspection period gives the Buyer some leverage to negotiate on issues discovered during the inspection period, and, if the Buyer's concerns are justified and the remedies financially acceptable, the Seller should take advantage of the inspection period to resolve these issues.

**G. Why Buyers Also Need Seller Representations and Warranties.** Despite the Buyer's inspection rights, representations and warranties from the Seller are often needed. These statements, if they are later found to be untrue, can be used by the Buyer to sue the Seller either for a breach of contract, if they survive closing, or for intentional or negligent misrepresentation. An inspection by the Buyer often will turn up incomplete records or inconsistent records, and representations and warranties by the Seller can often fill these gaps. Further, even complete books and records often do not document un-filed claims, demands, or even ownership of the assets. A Buyer inspection will not reveal problems or defects in buildings, equipment, and other assets that are not observable by the naked eye, and representations and warranties can cover these matters. Representations and warranties are often used to ensure that the Seller: continues to operate the business as normal; reports any adverse notices, orders, or actions to the Buyer; and continues to pay debts and liabilities between execution of the contract and closing. Representations and warranties can also be used to have the Seller guarantee that all the business books, records, and reports provided to the Buyer are true and accurate, since the Buyer has to rely upon these documents in analyzing the business's value and financial condition.

**H. Representations and Warranties a Seller Should Not Give.** A Seller should not give representations and warranties regarding:

1. Matters that the Seller has always assumed to be correct, but never verified, such as zoning or the impact of other laws upon the business.
2. Tax consequences of the transaction.
3. Legal consequences of the transaction.
4. Matters that the Buyer can determine itself during the inspection period.
5. Future performance of the business.
6. Claims or liabilities which may exist but are unknown by the Seller.
7. Full compliance with all tax, employment, health and safety, environmental, and other laws and regulations, since even the most knowledgeable business owners may not be familiar with all the provisions and ramifications of these laws and regulations.

**I. What Terms the Buyer Needs, and Should Review, in the Business's Premises Lease.**

1. Rent. The rent amount and other required payments should obviously be reviewed.

a. If there is a charge – called a “CAM charge” – for common area maintenance, repairs, insurance, and real estate taxes, the Buyer should look at how the building’s or shopping center’s total square footage is calculated. The total square footage should be calculated based on all *rentable* space, not all *rented* space. CAM charges allocated based upon rented space means that if, for example, half of the building or center is vacant, then all of the CAM charges for the *entire* building or center are spread among those tenants renting only *half* of the building or center. In fact, it is the landlord who is truly responsible for the remaining portion of the building or center that is not rented and, therefore, the landlord should be absorbing one half of the CAM charges in this example.

b. How often and by how much rent increases should also be reviewed. Typical currently is an annual increase at the higher of the CPI Index or 3%.

2. Security Deposit. This amount should be reviewed. One month’s rent plus sales tax is typical, with maybe the last month’s rent also being escrowed as a part of the security deposit. If the Buyer is assuming an existing lease, the landlord should be consulted as to whether there are currently any problems with the premises for which the landlord would claim all or a part of the security deposit. If so, maybe the Seller should credit the Buyer for that amount.

3. Triple Net Leases. Most commercial leases require the tenant, in addition to paying rent, to pay for (a) repairs and maintenance to the premises, (b) building insurance for the premises insuring against both casualties and liabilities, and (c) real estate taxes apportioned to the premises. These three payments, made in addition to the rent, are the “triple” that make the gross rent payment actually the “net” amount that the landlord receives as rent, hence a “triple net lease.” In addition, if the premises form part of a larger building or center, as we have discussed above, the landlord will often require a CAM charge for repairs, maintenance, insurance, and real estate taxes for the building’s or center’s common areas, on top of the charges for the premises themselves. The CAM charge is proportionate to the ratio that the premise’s square footage bears to the overall building’s or center’s square footage. The provisions of the lease in regard to these charges should be reviewed. *Note:* if the tenant is required to maintain and repair the premises, this typically includes repairing and even replacing the air conditioning and heating units. Therefore, it is imperative, especially with large premises, which have expensive units, to have them inspected to determine their remaining life expectancy. If life expectancy is low, the tenant should have the landlord agree to replace the units when the time comes at landlord’s expense, with the tenant agreeing to provide normal maintenance in the meantime.

4. Lease Term and Extensions. Optimally, a tenant should seek to obtain a lease with a short initial term (1 or no more than 2 years) followed by as many term extensions or renewals as possible of the same length. Even if a tenant needs to close a business

because of financial difficulties, lease agreements still require that the rents be paid for the remaining months of the current lease term. The benefit of a lease with a short term that can be extended many times is that, if the business develops financial problems, the amount of future rents owed will be smaller. Once a business is established, however, in a particular location with which its customers are familiar, it is both risky and costly to move that business to another location and notify all the customers, some of whom are invariably going to think the new location is less convenient. Therefore, the longer the lease term *through the extensions*, the better.

5. Options to Buy. Even better than a long lease term would be a option to purchase the premises, if landlord is willing to give one. For a tenant to break even cash flow-wise, the purchase price should be one for which, after no more than a 30% down payment, the remaining balance of the price could be amortized over 25 years with the mortgage payment not exceeding the rent amount.

6. Assignability. Ideally, the lease should be assignable without restriction by the tenant as long as the new tenant has the same net worth and income levels as the current tenant. At a minimum, the lease should allow the tenant to assign, provided that the landlord consents and that “such consent cannot be unreasonably withheld.”

7. Signage. Any signage restrictions for the premises should be reviewed in order to ensure that they are acceptable to the tenant.

8. Build-Out. If the premises are not completely built out with such amenities as bathrooms, interior walls, final paint, ceilings and flooring, the tenant should either obtain the landlord’s written obligation in the lease to provide these items or an upfront credit to the tenant for these items.

9. Tenant Enhancements v. Improvements. Most leases distinguish between tenant enhancements, which are not permanently attached to the premises and can be removed by the tenant when the lease terminates, and tenant improvements and fixtures, which *are* permanently attached and *cannot* be removed. However, if the Buyer is planning on installing large, built-in pieces of expensive equipment – for example, a walk-in refrigerator – that would ordinarily be considered non-removable improvements, special provisions should be inserted in the Buyer’s lease permitting removal. In return, the Buyer will generally be required to agree to return the premises to their prior condition, by, for instance, replacing carpets or flooring, taking down dividing walls, and restoring outside walls altered to accommodate exhaust vents. If this provision is not inserted in the Buyer’s lease, this type of expensive, built-in equipment will be deemed a permanent, non-removable improvement, and the landlord will be entitled to keep it after the Buyer’s lease ends.

10. Parking. The tenant should make certain that parking is adequate. If not, the lease should reserve enough convenient parking for customers, plus additional parking for the tenant and its employees.

11. Exclusive Tenancy. If the tenant believes that its lease is important and valuable to the landlord, and the premises are in a larger building or center, the tenant should request a lease provision that restricts the landlord from leasing space to a prospective tenant whose business would compete with the buyer's business.

**J. What the Seller Wants from the Landlord.** If the Seller has been leasing the business premises, the Seller wants the landlord to agree to two terms:

1. Landlord's consent to the Seller's assignment of its duties and obligations as tenant under the lease to the Buyer, and the Buyer's assumption thereof, which consent is critical if the business sale is to be consummated.

2. Landlord's consent to the assignment and assumption of the lease does not release the Seller from its duties and obligations as tenant under the lease. Therefore, the Seller must obtain in writing landlord's release of the Seller from all of its duties and obligations under the lease.

**K. Which Existing Business Liabilities the Buyer Can and Cannot Avoid.**

1. Stock Sale. In a stock sale, when the Buyer purchases a controlling interest in the corporation and therefore the business, the Buyer cannot avoid any costs or liabilities, known or unknown, disclosed or undisclosed, vested or contingent, of the corporation or business since they were incurred by the corporation or business. The only recourse for the Buyer is a lawsuit against the Seller, if the Seller misrepresented whether the costs or liabilities existed or their amounts.

2. Asset Purchase. In an asset purchase, the Buyer can avoid all costs and liabilities incurred by the Seller prior to closing, unless the Buyer expressly agrees to legally assume those costs or liabilities in the contract. Although the following costs or liabilities are not legally those of the Buyer, they may end up becoming a cost or a liability that the Buyer may wish to pay or be forced to pay from a practical standpoint:

a. Monies owed to a key vendor of the business that are not paid by the Seller on or before closing may cause the Buyer a very real practical problem if the vendor refuses to continue to provide its products or services to the business unless the debt is paid.

b. The situation in which benefits are owed to employees, and the Seller neither pays the employee directly nor pays the Buyer so that the Buyer can provide the benefits in the future, is also a problem. If the Buyer does not provide these benefits because the Buyer is not legally obligated to do so, employee morale will be adversely affected along with the business.

c. Real estate taxes, if the business has real property, and tangible personal property taxes have to be paid in full by their current owner each year, so the Buyer should ensure that these taxes are prorated.

d. Yellow pages advertising is often a continuing cost that the Seller will contractually require the Buyer to assume, and it has some benefits, but the Buyer needs to budget in the monthly additional cost of this advertising.

e. Equipment rent may be unavoidable for key equipment that is rented and that the business must continue to have.

f. If the business includes a motor vehicle, the Buyer will have to pay title transfer fees and sales tax on its value, if the Buyer does not collect those fees and taxes from the Seller at closing pursuant to a contractual provision to that effect.

Therefore, the Buyer should use the inspection period to determine if any of the above costs or liabilities exist and use the leverage from the Buyer's right to cancel the contract during the inspection period to obtain appropriate agreements from the Seller regarding the handling of these matters, if these matters are not already handled by contract provisions.

**L. The Dangers of (1) Leased and Financed Equipment and Other Business Assets Not Owned By the Seller and (2) Judgments and Tax Liens - and How to Detect Them.**

1. The Danger. The Buyer must protect itself from purchasing and paying the Seller for equipment and other business assets, only to discover after closing that these assets were financed or leased by the Seller and that the Buyer must continue to make payments thereon, despite having already paid for these assets as part of the business purchase price paid to the Seller. The Buyer may also have to make payments to third parties who obtain judgment or tax liens against the Seller, which then attach to the Seller's business assets now owned by the Buyer.

2. UCC Search. A closing attorney can discover such financed or leased assets by conducting a Uniform Commercial Code search for financing statements filed with the State of Florida. These financing statements must be filed to create binding equipment leases and valid liens on equipment and assets. If such leases or liens exist, the attorney will require that the leases or liens be paid off by the Seller on or before closing.

3. Judgment and Tax Lien Search. In addition, the attorney will perform a judgment and tax lien search to ensure that the Seller and the Buyer do not have any of these liens against them which would attach to the business assets and be superior to the Buyer's ownership rights in the business assets or to the Buyer's lender's lien rights in such assets. If such judgments or tax liens have been filed against either party, the attorney will require that party to pay them off on or before closing.

**M. The Importance of Inventory at Closing for Many Businesses.** Many businesses are retail businesses such as grocery stores, restaurants, or department stores which make their profits by selling products. It is a common mistake in business sale contracts to set a price for the business, but not require that a certain amount of inventory be on hand at

closing. Therefore, unscrupulous Sellers can increase their profit from the business sale by selling down inventory and not replenishing it. Then, when the Buyer takes over the business after closing, the Buyer has no inventory to sell, business sales are lost, and customers are unhappy. On the other hand, it is almost impossible for a Seller to have a precise, agreed-upon amount of inventory on hand at closing, since sales over a short period of time can be unpredictable. Therefore, Sellers do not like to agree to a specific amount of inventory. The solution is to have an inventory formula that adjusts the purchase price to whatever inventory is present at the time of closing and gives the Seller a range of inventory levels, not a precise amount, within which the Seller must ensure the inventory level at closing falls.

#### **N. The Greater Importance of Seller-Financing in Business Versus Real Estate Deals.**

Unlike mortgage loans on primary residences, which are the least risky loans a lender can make, loans to young businesses and loans to new owners even of established businesses are some of the riskiest loans. These loans are so risky that most banks will not make them at all unless the owner is able to provide (1) additional collateral other than the business assets, and (2) proof of income from sources other than business. Therefore, most Sellers of small businesses must understand that they will need to finance the sale of their own business, unless an Small Business Administration (SBA) guaranteed loan is obtained from a bank, but these loans also have their drawbacks.

#### **O. The Pitfalls of SBA Guaranteed Financing to Sellers and Buyers.** The SBA does not loan monies but simply guarantees loans made by private commercial lenders. Some of the pitfalls of SBA guaranteed loans are:

1. The approval process is very lengthy in that, not only must the private commercial lender approve the loan and its terms, but the SBA must also give approval.
2. The SBA's approval process can be somewhat subjective because the SBA will only approve applicants with "good character and management capabilities," in addition to looking at the amount of collateral and the owner's equity contribution to the business purchase. Further, the SBA cannot guarantee loans for "non-sound business purposes."
3. The SBA cannot guarantee loans exceeding \$2,000,000.00 and its guaranty cannot exceed 75% of the loan value.
4. New real estate investment companies and new banks, finance companies, or other lenders are all ineligible for SBA loans.
5. SBA loans are not available for purchase of the interest of less than all of the owners of a business.
6. The term of SBA loans cannot exceed (a) 7-10 years for working capital, (b) the economic life of business assets other than real estate, and (c) 25 years for real property

and equipment. If the loan is for a mixture of assets, its term will be an averaged period of time.

7. The SBA's fees for guaranteeing loans are as follows:

- a. \$150,000.00 or less 2% of the loan
- b. More than \$150,000.00 to \$700,000.00 3% of the loan
- c. Greater than \$700,000.00 to \$1,000,000.00 3.5% of the loan
- d. For that part of the loan Greater Than \$1,000,000.00 3.75% of the loan
- e. During the life of the loan, an additional 0.55% is added to the lender's interest rate as an on-going SBA fee.
- f. There is an SBA prepayment penalty for loans with a maturity of 15 years or more where the prepayment is made during the first 3 years and the prepayment exceeds 25% of the loan balance. The penalty is 5% during the 1<sup>st</sup> year of the loan, 3% during the 2<sup>nd</sup> year, and 1% during the 3<sup>rd</sup> year.

8. All owners who have title to 20% or more of the business must guarantee an SBA loan, so it is hard for someone to use investors to buy a business and simultaneously use an SBA loan.

9. Often, Sellers have agreed in the sales contract to take back a second note and mortgage or security agreement, but if an SBA lender is going to hold the first note and mortgage or security agreement, more often than not, the SBA requires the Seller to give up its second mortgage or security agreement and accept an unsecured, subordinated promissory note. This requirement typically contradicts the sales contract, and, if the Seller is unwilling to acquiesce to the requirement, it places the Buyer in a position of breach or default under the sales contract, often allowing the Seller either to sue the Buyer for damages or to cancel the contract and retain the Buyer's deposit.

**P. What Is Purchase Price Allocation and Why Is It Important?** The Internal Revenue Code as enforced by the IRS requires that both the Seller and the Buyer treat the reporting and computation of the tax on the business sale in the same way. The IRS groups the assets involved in the business sale into certain categories and requires that the sales price be allocated among these asset groups in the same amounts by both the Seller and the Buyer. This allocation is very important in that it determines the Seller's capital gains or losses, the deductibility thereof, and whether there is depreciation recapture. For

the Buyer, the allocation will determine how fast the Buyer can depreciate and expense the business assets. Therefore, the business sale contract should either:

1. Set forth an agreed-upon purchase price allocation, which requires the Seller and the Buyer to agree to that allocation prior to entering into a contract;
2. State that either the Seller's or the Buyer's CPA shall reasonably allocate the sales price in good faith, and that said allocation will be binding on both the Seller and the Buyer; or
3. Require that the parties agree to the allocation during the inspection period, failing which the Buyer can either accept the Seller's requested allocation or cancel the contract and have its deposit(s) returned.

**Q. The Importance of CPA Involvement on Both Sides.** As discussed above, the CPAs of both the Seller and the Buyer are very important in determining an allocation of the purchase price. A Seller's CPA can also advise the Seller as to the income tax advantages and disadvantages of, for example, (a) full payment by the Buyer of the business sales price at closing versus payment for the business in installments and (b) closing in one tax year versus another tax year. A Buyer's CPA can be invaluable in (a) setting up the business budgets discussed above, (b) selecting accounting software, (c) creating the bookkeeping procedures for the business, (d) training the bookkeepers, (e) designing financial statements tailored to the business owner's needs, and, of course, (f) filing the business's income tax return. These services can save both Sellers and Buyers substantial taxes.

**R. How the State of Florida Can Make the Buyer Pay the Seller's Unpaid Sales Tax Despite the Contract's Terms to the Contrary, and How to Avoid this Unpleasantness.**

The Department of Revenue ("DOR") of the State of Florida has a tax regulation that states if a Buyer purchases a business and does not call and have the DOR perform a sales tax audit on the Seller and the business, the Buyer will be liable to the DOR for all sales tax returns not filed by the Seller and all sales taxes unpaid by the Seller. As you might expect, no Seller is willing to sell their business to a Buyer who insists upon this procedure to protect itself from the tax liability. Thus, the sales contract should have a representation and warranty from the Seller that all such tax returns and taxes have been filed and paid, respectively, by the Seller. Further, the Buyer should make use of the inspection period to have its CPA compare the revenues shown on the business's monthly financial statements against the revenues shown on the monthly sales tax returns, and then ensure that those returns and the sales taxes required to be paid pursuant to those returns were in fact filed and paid. If the CPA's review finds discrepancies in the returns filed or the taxes paid, the Buyer may request the Seller to correct these discrepancies during the inspection period, failing which, the Buyer may cancel the contract during that period and have its deposit(s) refunded.

**S. Tangible Personal Property Taxes on Businesses.** Many people are unaware that each county in Florida collects an ad valorem tax not only on real property, but also on the tangible personal property of businesses. The tangible personal property of a business consists of all tangible assets that are not land, buildings, or fixtures currently attached to buildings. “Tangible” means that the asset which has the value has a physical presence. Therefore, money, bank accounts, accounts receivable, and other intangibles, which do not have a physical presence, but are simply represented by paper, are not taxed. To determine the tax, all business owners are required to file, by May 1<sup>st</sup> of each year, a tangible personal property tax return with the county property appraiser, which return lists the tangible personal property by name, the number of items, and their value. In November of each year, the county tax collector issues a tax bill based upon the value of said property. Whoever owns the property in November must pay the tax even if they did not own it during the entire year. Therefore, the closing attorney will prorate the tangible personal property taxes on the settlement statement.

**T. The Seller’s Agreements of Non-Competition, Non-Hiring, and Confidentiality.**

Most businesses are successful based upon many different factors such as the likeability of the owner; the owner’s sales abilities; the owner’s expertise in delivering the business’s products or services; the cooperation of key vendors; the skills, abilities, and dedication of the business’s employees; pricing and costing formulas; existing and potential customer information and lists; trade secrets; specially designed software; and special aspects of products and services and the equipment and processes used to produce or provide them that have not been publicly disclosed and are not a matter of common knowledge. Thus, it is essential that the Seller not be allowed to open up a new business or join an ongoing business in competition with and providing the same services or products as the business that Buyer is purchasing. The restriction on the Seller is typically a restriction against the Seller, directly or indirectly, opening up a new competing business or joining an ongoing business within a certain geographic radius of the current business for a certain period of time. Further, a confidentiality agreement is signed to keep business information secret, and a non-hiring agreement is used to keep the Seller from hiring away employees of the current business. Without these essential restrictions, a newly purchased business may be stripped of most of its value if it loses its customers, trade secrets, and employees back to its former owner, the Seller.

**U. Post-Closing Price Set-Offs and Contingency Escrows for Claims, Unexpected Losses and Liabilities, Loss of Employees, Etc.**

1. The Problems. It is always very possible for a Buyer to miss problems such as debts and expenses during the inspection period. Other claims and liabilities may not be able to be determined from the books and records provided. Some claims and liabilities are contingent or are unknown and may or may not ever occur. Key employees, customers, and vendors may not stay with the business after the sale. Also, the Seller’s representations and warranties may turn out to be untrue. While the Buyer may theoretically sue the Seller for representations and warranties that were untrue and

negligently or intentionally made by the Seller, lawsuits are expensive, stressful, time-consuming, and have no guaranteed outcomes.

2. The Solutions. To guard against these problems and liabilities, the Buyer has several options if the Seller agrees. First, if the Seller is financing the sale of the business, the Buyer can insist upon an off-set clause being placed in the business sales contract, which allows the Buyer, after time is provided for the Seller to remedy the problem, to off-set against payments due under the promissory note to the Seller, any claims, liabilities, costs, or expenses identified in the contract that accrued prior to closing but were not paid by the Seller. The second solution is to insert an escrow provision in the contract which requires a certain negotiated portion of the Seller's sale proceeds to be escrowed with the closing attorney as escrow agent for a certain period of time, such as 90 or 180 days. The Buyer would then submit to the escrow agent any claims, liabilities, costs, or expenses identified in the contract that accrued prior to closing but were not paid by the Seller, and the escrow agent would, after time is provided for the Seller to remedy the problem, then pay such claims, liabilities, costs, or expenses from the escrowed funds.

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