

The Tax and Business Professionals
Checklist for Business Purchases

Revised April, 2009

CHECKLIST FOR BUSINESS PURCHASES OR SALES

1. **What is to be Purchased or Sold?**
 - (a) Assets or the Business Entity (corporation, LLC, partnership)?
 - (b) If Assets, which assets?
 - (1) Inventory
 - (2) Accounts Receivable
 - (3) Equipment, furniture, fixtures
 - (4) Land/Building
 - (5) Goodwill, intangibles, trade secrets

2. **Terms of Payment: Total Purchase Price \$ _____**
 - (a) Down \$ _____
 - (b) When paid and who will hold
 - (c) When Balance Due
 - (d) Promissory note - terms
 - (e) Seller's debt assumed or paid off
 - (f) UCC security interest in assets/stock – if default occurs
 - (g) Letter of credit
 - (h) Closing date _____

3. **Inventory -- Use, Verification, Control**
 - (a) Separately listed items or in bulk
 - (b) Special treatment (refrigeration?)
 - (c) Who is to check inventory
 - (d) Normal resupply and control prior to closing
 - (e) Unsuitable, unusable or obsolete inventory

4. **Check Prior Performance Records**
 - (a) What records to be made available
 - (b) For what prior periods
 - (c) Unusual pricing arrangements
 - (d) Discounts
 - (e) Worker's Compensation claims
 - (f) Employee records and policy manuals
 - (g) Is (was) there a business plan

The Tax and Business Professionals
Checklist for Business Purchases

Revised April, 2009

- 5. Check Accounts Receivable -- Verification and Aging**
 - (a) Who to collect accounts after closing
 - (b) Final list as of when _____
 - (c) Check payables if stock purchases
 - (d) Who is to determine if bad accounts

- 6. Coordinate Furniture, Fixtures and Equipment**
 - (a) All to buyer
 - (b) If not, what is seller to keep
 - (c) Value to be shown on separate list
 - (d) Computers and related files and records

- 7. Review Warranties on Equipment**
 - (a) Which equipment
 - (b) Types of warranties
 - (c) If no warranties and one important machine, consider cash escrow for performance.

- 8. Consider Covenant Not to Compete**
 - (a) Who is prohibited from doing what
 - (b) For how long - time
 - (c) What area covered
 - (d) Consideration allocated to covenant
 - (e) State law may limit enforceability
 - (f) IRC § 197 requires 15-year amortization by buyer (see # 25, below)
 - (g) May be self-employment income to seller

- 9. Review Leases**
 - (a) Get copy -- check expiration date
 - (b) Are leases assignable
 - (c) Check for assignments and subleases
 - (d) Renegotiation of lease possible
 - (e) Zoning allows intended use
 - (f) Ask for copy of detailed building floorplan

- 10. Check Union Contracts and Commitments**
 - (a) Pending union claims or violations
 - (b) Fringe benefits in excess of union contract
 - (c) Labor abuses (past)
 - (d) Overtime -- Department of Labor

The Tax and Business Professionals
Checklist for Business Purchases

Revised April, 2009

11. Review Qualified Retirement and Fringe Benefit Plans

- (a) Copies furnished for all plans
- (b) Should plan or benefit be assumed
- (c) Cost to fund and maintain
- (d) Approval letter received from agency
- (e) Annual reports filed
- (f) Performance of plan administrator

12. Bulk Sales Law Compliance

- (a) Is there a bulk sale of inventory
- (b) Are there inventory creditors
- (c) If so, Seller or Buyer to comply
- (d) Claims to be handled in advance or how

13. Review Pending or Expected Litigation

- (a) What and how to handle
- (b) Projected costs

14. Seller Financing

- (a) What is to happen if there is a default in Buyer payments
- (b) Rights of inspection during payment period
- (c) Collateral or security for Seller financing
 - (1) Assets or entity interests sold
 - (2) Real estate of Buyer
 - (3) Accounts receivable
 - (4) Inventory or equipment
 - (5) Personal guarantees
 - (6) Covenant that Buyer will not compete with defaulted business
- (d) Filing (perfection) of security interests for Seller financing
- (e) Personal guaranty of payment (see # 15, below)
- (f) Standby letter of credit

15. Personal Guaranties of Payment by Buyer

- (a) On what and for how long
- (b) Guaranty provided by whom
- (c) Security for performance
- (d) Credit check of guarantor
- (e) Cash escrow to be established

The Tax and Business Professionals
Checklist for Business Purchases

Revised April, 2009

- (f) Two signatures on an escrow-type bank account with arbitration provisions
- (g) Continuance of representations (how long)

16. Review Employment Agreements, Bonus Policies, and Deferred Salary Arrangements

- (a) With whom
- (b) For how long
- (c) Deferred salary arrangements
- (d) Transition problems

17. Review Conduct of Business Until Closing

- (a) Operations as normal
- (b) Discussions with employees, by whom
- (c) Announcements and communications
 - (1) Trade accounts
 - (2) Customers
- (d) Incurrence of new debt pending closing
- (e) Accidents and insurance coverage kept in force

18. Insurance Policies

- (a) Are policies available
- (b) Can coverage be arranged
- (c) Is existing coverage adequate

19. Representations and Warranties

- (a) Representation - - Statement of Present, past or existing fact true at some point (Example, there have been no tax audits, lawsuits, and the like)
- (b) Warranties - - Guarantee that a certain condition exists or will continue (Example, Seller will maintain certain assets to pay unexpected claims)
- (c) Consider indemnification provisions for breach of warranty or incorrect representations (see # 21, below)

20. Matters often Subject to Warranties or Representations

- (a) Entity in "Good Standing" and qualified to do business
- (b) Authority to sell and deliver assets or stock
- (c) Financial information accurate
- (d) Title to Assets valid

The Tax and Business Professionals ***Checklist for Business Purchases***

Revised April, 2009

- (e) Third Party Rights - - no unknown claims, commissions, or encumbrances
- (f) Government Consents, if needed, obtainable.
- (g) Hazardous substances or conditions
- (h) Litigation - - pending or likely
- (i) Licenses and Permits - - liquor licenses, etc.
- (j) Compliance with applicable laws
- (k) Payment of Taxes
- (l) Bulk Sales Act
- (m) Employee Relations
- (n) ERISA (Employment & Retirement Income Security Act)
- (o) Personnel matters - - violations of employee protection laws, overtime pay, etc.
- (p) Assumption of Contracts - - any? which ones?
- (q) Brokerage and Finders fees
- (r) U.S. persons - - special laws for Resident or Non-Resident Aliens
- (s) Capitalization & Ownership of Stock and Assets
- (t) Condition and list of assets accurate
- (u) No conflict with existing Court or administrative orders
- (v) No material omissions

21. Indemnification, Escrows, and Set-Offs

- (a) Indemnifying party agrees to defend claims and pay; may want to specify who to handle claims and how settlement to be accomplished to avoid litigation
- (b) Indemnification for damages and costs from breach of warranty or incorrect representations (*see # 19, above*)
- (c) Does Indemnifying Party have sufficient liquid assets to pay
- (d) Escrow - - funds set aside to pay claims
- (e) When and how will funds be held and disbursed; who to decide when and how much
- (f) Signatures required to release escrowed funds
- (g) Set-Off - - reduction in payments because a condition exists (e.g., equipment fails), seller does not provide promised assistance, or unexpected claim arises
- (h) If set-off allowed, future installment payments are reduced accordingly

The Tax and Business Professionals
Checklist for Business Purchases

Revised April, 2009

22. Legal Opinions

- (a) Seller or Buyer's attorney(s) may be asked to provide legal opinion as to seller or buyer
- (b) Affords some additional due diligence on part of Seller or Buyer's attorney
- (c) Legal opinion needed if prior or pending significant litigation or administrative law problems (i.e. pending tax audit)

23. Major Liability Areas

- (a) Product Liability - - if stock purchased, claims for prior product liability continues
- (b) Environmental liability - - an emerging area. Watch for CERCLA (Comprehensive Environmental Response, Compensation & Liability Act). Here the Government has incredibly broad powers
- (c) Unpaid Taxes - - Seller should not assume
 - (1) Escrow funds for payment
 - (2) Order IRS transcripts for record of payments
- (d) Bulk Sales Act - - Designed to protect creditors of Seller
 - (1) List of Creditors
 - (2) Schedule of Property to be purchased
 - (3) Preserve records for six months
 - (4) Notify creditors as to who to pay what, often notice done jointly
- (e) Accounts Payable - - if a entity sale

* * * * * **Tax Considerations** * * * * *

24. Asset Allocations (IRC § 1060)

- (a) Form 8594 to be filed by both buyer and seller
- (b) Unless parties agree otherwise, purchase price must be allocated among various classes of assets using "residual method"
- (c) Consideration allocated to goodwill must be identified
- (d) Buyer must indicate if seller gave covenant not to compete or buyer entered into employment or management agreement with seller and the maximum consideration therefore
- (e) Allocation controls basis for both gain and depreciation
- (f) Better to allocate values in purchase agreement and, within reason, allocate more to amortizable or depreciable assets
- (g) Subsequent, unilateral allocations likely to be challenged by IRS

The Tax and Business Professionals
Checklist for Business Purchases

Revised April, 2009

- (h) Land not depreciable or amortizable
- (i) Consider completing and signing Form 8594 at Closing

25. "Amortizable [IRC] § 197 Assets"

- (a) Amortization of intangibles over 15 years for:
 - (1) Goodwill
 - (2) Going concern value
 - (3) Work force in place
 - (4) Books, records, and operating systems
 - (5) Patents, copyrights, formulas, know-how
 - (6) Customer base
 - (7) Licenses and permits
 - (8) Covenants (promises) not to compete
- (b) An exception -- Some software amortizable over 36 months

26. Recapture of Depreciation

- (a) Will Seller be subject to Recapture
- (b) Amount and effect on sale
- (c) Recapture income not subject to installment reporting

27. Deductibility of Salary & Other Payments to Sellers

- (a) Recharacterization of management, salary, or other payments (Covenant not to Compete) by IRS may result in additions to the non-deductible allocations to the purchase price
- (b) Can the person or entity to perform services actually provide service or compete?
- (c) Contingent Installment payments of Covenants
 - (1) Covenant payments not amortizable until incurred
 - (2) Imputed interest may be imposed

28. Installment Reporting

- (a) Fixed or contingent sales price
- (b) Maximum or minimum amount
- (c) Imputed interest on certain contingent deferred payment amounts

The Tax and Business Professionals
Checklist for Business Purchases

Revised April, 2009

29. Gain or Loss Characterization

- (a) Capital gain or loss on sales of capital assets
- (b) Ordinary income from sale of inventory, accounts receivable, recapture items

*Copyright 2009 Dan Newland &
The Tax and Business Professionals, Inc.
Manassas, VA 20110
(800) 553-6613*