

Buying or selling a 'business'? What's on the table?

By Fordham

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The decision to buy or sell a business can be both exciting and daunting at the same time. With the rising number of Baby Boomers stepping away from their privately owned businesses, these decisions are becoming more frequent for our clients. Considerations such as price, timing, taxation, deal structure, employees, warranties, indemnities and many more, can muddy the

waters. However, if we strip back a lot of the factors above, one of the most important considerations in any transaction is how is the transaction structured, being either a sale/purchase of shares or of business assets. Historically buyers preferred asset sales, whereas sellers would often prefer share/unit sales due to the taxation effects of each.

When our clients' approach us about either buying or selling a business, we offer methods on how to achieve the best outcome, remembering it is the after tax dollars that count!

When is the right time?

It is almost always too late to put a plan in place after somebody has knocked on your door looking to buy. As the saying goes, you can't fatten a pig on the way to market! Too often, we meet business owners who have been referred to us with a letter of offer asking us to help with their tax outcome. While we can assist to extract further value at this stage, they have missed a great opportunity to maximise value by not engaging an advisor who has extensive knowledge on both the transactional and taxation side of the deal earlier. Ultimately every business owner will be faced with succession at some stage in their business journey, and like all things, if you don't have a plan, then you won't be able to take full advantage of what, for most, will be a once in a life time event.

What is a share/unit transaction?

A sale of business transaction can be executed through the sale of shares in a company or units of a unit trust. The transaction is between the entities' share/unit holder(s) and the purchaser of the shares/units.

When there is a share/unit transaction, all the assets and liabilities of the business can remain with the entity. This results in the seller getting to 'walk away' from all entity liabilities (subject to any agreed price adjustments, warranties, guarantees and/or indemnifications) as the buyer acquires them.

An entity based transaction typically requires more effort at the due diligence phase of a transaction compared to a business asset based transaction. This is partly due to the potential liabilities (e.g. potential future litigation against the business, employee claims, etc.) that may not be present on the balance sheet.

However, for a purchaser, an entity based transaction is often beneficial, as the entity they are acquiring already has customer contracts, supplier/employee agreements and the trading business' name, as opposed to a business asset acquisition, where all these agreements need to be re-established.

What is an asset transaction?

An asset transaction allows the buyer to choose which assets and liabilities (that are owned by the entity carrying on the business) they will acquire. This transaction is between the entity and

the buyer of the business' net assets.

Assets may consist of any balance sheet item such as machinery, inventory, intellectual property, goodwill and fixed assets just to name a few. The consideration for these assets can be offset against liabilities that may also be acquired (this is determined through an acquisition analysis). The seller then transfers out these net assets in return for cash and retains ownership of the entity structure. Depending on how the cash is extracted, different tax outcomes can occur.

Whilst on the surface it may appear simple, there are still a number of complexities including employee contracts, supplier contract transfers, asset title and release of security interests, tax consequences, unrecorded liabilities etc.

A few considerations for share transactions...

Ease of continuity for the purchaser

Exactly what is to be transferred is usually identified during due diligence, but as a minimum, a purchaser would expect to acquire all things necessary to continue to generate the profit on which the valuation was determined. Vendors do not have to worry about tax extraction cash imposts. A simple advantage of a share transaction is that the business name and accounts are retained by the entity and thereby continue on with the new owner. This minimises the costs incurred by administrative delays. In many circumstances, consumers and customers may not even be aware of a change in ownership.

Unrecorded liabilities

Significant due diligence is required by a variety of professionals (tax, accountants and legal) to identify and quantify veiled liabilities that may include unrecorded tax liabilities, contingencies for potential litigation from customers, suppliers, employees, or potential future damages from environmental or other social or community issues.

Employees

In a share transaction, it is normal that employees remain with the entity (and therefore transfer with the entity as being under the control and direction of the purchaser). This is because the legal identity of the employer has remained unchanged. It is worth noting that there is a potential trigger of rights under employee agreement contracts which can result in the employees benefits having to be paid in accordance with the change of control in the business. Typical examples would be bonuses or other incentive arrangements.

Contracts

A share transaction does not present a legal assignment issue. This relates to contracts in the transfer of rights. In a share transaction because the contractual party remains the same, there

is generally no problem relating to entity contracts as rights do not have to be transferred. This protection, however, can be made void by a 'change in underlying control provision' clauses within contracts. As such, it is important to carefully review the terms and conditions of key contracts.

A few considerations for asset transactions...

Employees

Usually employee contracts are with the vendor. Employment contracts, unless otherwise stipulated, are not transferrable as they are personal in nature. New contracts, or letters of assignment, may need to be entered into with employees by the purchaser. This requires a considerable amount of time as the treatment of accrued entitlements varies depending on the terms and conditions of employment for each employee. A purchaser needs to mirror basic employment parameters for potential deemed redundancy. The purchaser must also assume outstanding leave obligations including long service leave.

Tax consequences

For the purchaser, asset values can be impaired to market values within specific guidelines. This can reduce future tax liabilities benefiting the purchaser. A seller can benefit through realising tax losses to offset other tax liabilities resulting from the sale. Additional tax considerations may include GST and duties. For GST, if all of the business assets are transferred, the sale may result in a sale of a going concern, i.e. no GST being payable (or claimable) on the transaction, whereas if only a select amount of assets are purchased, a GST liability may arise. For duties, stamp duty or land tax may be payable depending on the state in which the land, property, debtors, inventory and other assets are located.

Contracts

Assignment of contracts refers to the transfer of contractual rights. With an asset transaction, an issue arises as the contractual party has changed. Commonly, third-party consent is required to allow assignment; it can also be the case where assignment is not possible at all. In circumstances where key contracts can't be assigned, the value of the business to the purchaser may be considerably less.

The final transaction method can have a material impact on the profitability of the transaction for both the buyer and seller. Irrespective of the method, it is critical that both parties conduct appropriate due diligence to safeguard against any potential risks. These contracts, combined with effects on future business plans, require specialist advice, even for the most sophisticated of investors.

Like to know more?

In order to maximise your sale or purchase price or ensure you don't pay more than is required for an acquisition, it's critical to start planning early. What are you willing to accept/pay for a business? You can't fatten a pig on the way to market: even if you aren't looking to sell now, it is not uncommon for business owners to have a knock on their door, and when that time comes, it's crucial that you're ready. If you're looking to buy, it's key to get advice early on the process to ensure that all bases are covered and that you get what you're paying for.

This is where expert advice from a trusted advisor can really make a difference. If you are thinking of buying or selling a business, please contact your [Fordham Partner](#).

Talk to us today

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