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Purchasing a Business

Purchasing a business requires an enormous amount of research and preparation and detailed knowledge of the relevant industry. Detailed below are just some of the matters that need to be considered.

Assessing the business

It is essential you fully understand the financial accounts of the business. You should go through them carefully with your accountant to obtain an objective view on how much the business is worth.

Purchase of business or shares

Purchasing the business involves the acquisition of its assets, fixtures and fittings, business name, intellectual property, plant and equipment, vehicles, lease of business premises, stock in trade and goodwill. Unless specifically stated otherwise, you are not purchasing the vendor's debts or liabilities. Transfer duty is payable on the purchase price.

On the other hand, if the business is owned by a company, you may purchase the shares in the company instead. In most cases no transfer duty is payable, however you are purchasing the company warts and all. In other words, you purchase not only what the company owns but also what it owes, whether disclosed or undisclosed. So while there may be some transfer duty saving, there is considerable added risk and the due diligence to be carried out by your accountant and solicitor will be much more involved and costly.

Purchasing entity

The legal structure of the purchasing entity is an important matter to get right. The usual choice is between sole trader, partnership, private company or a trading trust (with either a personal or a corporate trustee).

A private company has the advantages of limited liability although this can be eroded by the requirement to provide personal guarantees. Tax on company profits is lower than personal income tax rates and you can issue and transfer shares in a company relatively inexpensively.

With a sole trader or partnership of individuals, losses can be offset against the individuals other income and the structure is less expensive to set up and maintain. The owner is however personally responsible for all liabilities of the business.

A trading trust will be either a discretionary trust where the trustee determines how the income will be distributed each year, or a unit trust where entitlements are fixed. A corporate trustee can provide additional asset protection. One advantage of a trust is that it can access the 50% capital gains tax discount on the sale of the business, whereas a company cannot.

There are a number of other variations on the above structures which is beyond the scope of this paper to discuss. The important thing is to obtain advice before the purchasing entity is decided upon.

Apportionment of the Purchase Price

The apportionment of the purchase price can be a tug of war. As a purchaser you will want a higher amount of the purchase price to be attributed to stock in trade (which can be fully deducted) and plant and equipment (which can be depreciated over time). The vendor will usually receive a better tax treatment if a higher amount of the purchase price is attributed to goodwill. For this reason the apportionment of the purchase price in the contract is often left blank.

Restraint of Trade

You should insist on a clause whereby the vendor is retrained from setting up, operating or being involved with any other business in competition with the business being acquired for a reasonable time within a reasonable area.

The area depends on the location of the customer base. A reasonable time is usually 2 to 3 years, but can differ depending on the type of business. It is important to be fair and reasonable, as an unfair restraint clause can be struck out by a Court and will be of no effect.

Training

You can insert a clause in the contract whereby the vendor has to give you training prior to settlement and provide assistance following settlement. During the training period you should get to know as much as you can about the customers, suppliers and employees of the business so that you can operate it effectively and efficiently from the settlement date.

Due Diligence

It is vital to undertake proper due diligence investigations on a business. Usually business contracts will be signed subject to a reasonable due diligence period. During this period you should, with the help of your accountant and solicitor, thoroughly investigate all aspects of the business including financial operation, customers, suppliers and employees. You need to be confident that you can continue to operate the business as profitably as the vendor.

Lease of premises

If the business operates from leased premises then the lease will need to be transferred to you on settlement. The landlord will need to consent to the transfer of the lease to you. The landlord may require you to provide personal guarantees and a security deposit.

You need to investigate the lease including the current term and options and when and how the rent is to be reviewed. If there is a market review in the future, you should investigate what the market rent is likely to be and compare that to the current rent being paid. You should also investigate the level of outgoings payable under the lease which can be significant.

Stocktake

Usually the contract provides for a stocktake to be carried out on the date of or the date prior to completion. The price for the stock is usually payable on completion. Alternatively, if you purchase a business on a walk in walk out basis, the purchase price includes all stock. Be careful however as this means the vendor will usually run down the stock prior to completion unless a special condition is inserted. Often a maximum price for stock is inserted so that any excess stock will either be thrown in with the sale for free or retained by the vendor.

Plant and Equipment

It is important to inspect the business premises prior to signing a contract so you can check the inventory attached to the contract contains all the plant and equipment needed for carrying on the business. Often the business will have plant and equipment which is not owned by the vendor but is subject to a chattel lease or hire agreement. Usually the relevant financier will either agree to a new agreement with you or consent to an assignment of the lease or hire agreement to you. In both cases, you will become responsible for the lease or hire payments from completion. If you want title to all plant and equipment unencumbered, then the contract should provide that the vendor must pay out all leases on completion.

Employees

On settlement you must ensure that the vendor pays all entitlements owing to employees up to the date of completion. Usually an adjustment is made on completion in favour of the purchaser for 70% of any accrued but unpaid holiday pay for all employees and long service leave for employees with 5 or more years of service. You should investigate all employee agreements during the due diligence period and be in a position so you can decide prior to completion which employees you want to keep and which ones you do not.

There are many legal matters to consider when buying a business and not all are dealt with here. It is therefore important that you get proper advice before signing a contract.