Advice Guides

Level 9, 65 York Street, Sydney NSW 2000 | Tel: (02) 8296 6222 | www.townsendslaw.com.au

"WHAT IS A BUSINESS"

Dictionary definitions won't help you. A potential Seller or Buyer of a business must ask: "What am I Selling/Buying?"
The answer is: "A conglomeration of legal rights and obligations loosely called "a business"."
Or, put another way: "A collection of assets, real and personal, tangible and intangible, which used in a certain way can turn a profit."

It is essential to identify each asset or component individually so it can be effectively transferred from Seller to Buyer. This is part of what is known as doing "due diligence" on a Business.

These components usually include the following:

1. business name
2. right to occupy the premises (lease)
3. plant & equipment
4. fittings and fixtures
5. stock
6. goodwill
7. telephone number(s)
8. employees
9. supply agreements
10. current orders
11. registered designs, patents, licences, trade marks
12. statutory licenses used in the business

The Seller must be prepared and able to give good title to all of the above. The Seller must be sure this is possible before putting the business on the market. The Buyer must be prepared and able to accept good title. The Buyer must check that it is being sold everything necessary for the proper efficient and profitable running of the business.

THE SELLER	THE BUYER
Considerations for each party and the various parts of the transaction.	
The Agent	
The agent is your agent. What they tell others when acting as your agent may therefore bind you, the Seller.	Unless the agent's representations are included in the sale contract, you may not be able to rely on them. Double check them.
The Identity of the Seller	
Make sure you know exactly who owns the business and therefore has the right to sell it.	Make sure you know exactly who owns each asset and therefore has the right to sell it.
Do different parties own different parts of the business? Reduce the business to its elements and check ownership of each component.	Reduce the business to its elements - does the Seller own all these elements?
If you don't and the wrong person sells, the tax consequences could be disastrous. (Not to mention the problems you'll have with the Buyer).	If you don't check, you may not obtain good title to all of the business.
The Identity of the Buyer	
If the Buyer is a company the Seller may need a personal guarantee from the Buyer to ensure that the deal goes through.	The Buyer should be the most appropriate entity to minimise tax and to provide liability protection for other assets. The Buyer could be: * Individual * Company * Trust
Has the Buyer the financial capacity to complete the sale?	You may need to provide guarantees that the sale will be completed.

THE SELLER	THE BUYER
The Price Specific values included in the Price are:	
a) Plant & Equipment ("Fixed" Assets)	
These are assets used in the Business itself: they are not the product of the Business. Eg vehicles, machinery, office furniture.	The amount for which it is purchased will be its opening value in the books of the Buyer and it can only be depreciated down from that value.
Produce an itemised list of the assets.	
If these are sold above the depreciated book value, the Seller may be liable to income tax on the excess.	
b) Goodwill	
This is capital in the hands of the Seller (Capital Gains Tax provisions) if acquired after 19/9/85.	Capital (ie non-deductible) in the Buyer's hands.
c) Stock in trade	
This consists of i) supplies used in the production of the goods for sale in the Business; ii) goods being produced and iii) finished goods. It should be valued just before settlement. It must be within 10% either way of estimate put in contract or the Buyer may refuse to buy it all.	Make sure you only buy saleable stock taht has a ready market and not obsolete or difficult to shift stock.
The Premises	
If the goodwill depends on the Business' location in any way, proper transfer of the premises will be vital to a successful sale.	
If you own the premises and they go with the Business, prepare sale documents ready for inspection.	No area has the potential to cause as much harm to the Buyer than this.
Check with your landlord before you put business on the market so you know his attitude. REMEMBER: Most leases give the landlord significant power when it comes to transferring a lease.	If location of business is associated with the goodwill, the Buyer MUST be sure he or she can obtain the legal rights to the premises by either - * transfer of current lease * new lease * purchase of real estate
Make sure you have the lease document handy before putting business on the market, so that Buyers can inspect it.	If leasing, amortise the purchase price over the absolute minimum period of the lease and make sure the business can repay that amount in the necessary time <u>and</u> provide desired income.

THE SELLER	THE BUYER
The Goodwill	
Determine what it is about the Business that gives it a value above the value of the assets alone	
Assess which names of the products/services contribute to the Business' goodwill.	Determine which names of products/services used in the Business contribute to its goodwill. Ensure registration before or at sale.
Ensure each of these is registered before putting the Business on the market so you have maximised the Business' sale value.	Produce an itemised list of the assets.
	Check other name registrations, other intellectual property rights that may be appropriate - Design Registrations Company Law Patents Trade Marks
Make sure you are happy to transfer telephone numbers, domain names and email addresses even if it means changing a private one	Ensure telephone numbers, domain names and email addresses properly transferred.
No Encumbrances	
The Seller will be required to pay out any - mortgages - charges - bills of sale, and other encumbrances over plant, equipment, fittings, fixtures and stock. Be sure you can do this easily and without burden of penalty interest.	The Buyer must check to ensure that all encumbrances are paid out - Bills of Sale search at Registrar General's office. - Bankruptcy search - Discharge of any mortgages, liens and caveats - if Seller is a company, an ASIC search.
For those items the subject of hire purchase or chattel lease the Seller must ensure that the agreements can be transferred to the Buyer or be prepared to pay them out (which can sometimes be expensive).	Buyer must ensure that the Lease Company or Hire Purchase Company agree to transfer the leases or hire purchase agreements - otherwise the Seller may remain as the owner of the goods - or Buyer may end up with goods which are encumbered.

THE SELLER	THE BUYER
Restrictive Covenant	
The Seller will need to promise the Buyer that the Seller will not compete with the Business after the sale.	The Buyer will want a promise from the Seller that the Seller will not compete with the business after the sale.
But the Seller will need to ensure that the promise does not limit his future activities too much.	But the Buyer must ensure that this promise is not too restrictive on the Seller, or otherwise the Court will not enforce the promise.
Employees	
Nothing the Buyer and the Seller agree on affects the statutory and award rights of the employees of the business. Various statutes ignore the sale of a business when calculating an employee's rights to entitlements such as long service leave, holiday pay, sick leave and the like. So:	
The Seller must ensure that the Buyer fulfills all obligations to the employees. If the Buyer defaults the Seller may become liable to the employees.	The Buyer must ensure that all obligations to each of the employees are known: and perhaps that amounts to cover these have been accounted for in calculating the purchase price.
The Seller should also try to ensure that key staff remain with the business.	Buyer should try to get agreement of key staff to continued employment prior to completion.
Existing Contracts	
If the Business includes work-in-progress, being the obligation to finish certain orders, the Seller needs to ensure those orders are properly filled or he may remain liable under those contracts.	If the Buyer is paying for work-in-progress as part of the purchase price he or she is in fact paying non-deductible CAPITAL for the right to receive assessable income. A discount factor should be applied in calculating that part of the purchase price relating to work-in-progress.
If the Business involves agreements with suppliers, the Seller must make sure that the suppliers will release the Seller from those agreements and accept the Buyer instead.	The Buyer must make sure that he or she has inspected all supply agreements so all rights and obligations under them are known, AND that the Supplier will agree to supply the Buyer on the same terms and conditions.

THE SELLER	THE BUYER
Tuition and Introduction to Client Base	
The Seller should ensure that he or she provides enough tuition to the Buyer to enable the Buyer to run the business effectively when it is taken over.	The Buyer wants enough tuition so that the takeover of the business can occur as quickly and effortlessly as possible.
The Seller should also be prepared to introduce the Buyer to suppliers, clients etc to protect the Goodwill.	Buyer needs to have the Seller's endorsement as the new Owner: Consider a flyer and personal introduction to key clients.
Seller's Warranty	
The Seller will not want to give a warranty as they may consider this is a hard and fast promise that the Buyer will make that money. This is not so!	Wherever possible the Buyer should try to get a warranty as to the financial basis of the Business. This is not a guarantee that the Buyer will make that money (it isn't),but if the business does not produce figures anywhere near the warranty figure AND there is no good reason for the downturn, it may be possible to sue the Vendor for misrepresentation or breach of the warranty.
The Seller may not want to give a warranty because the actual takings of the business may not all have been put through the books.	
Licences	
If the conduct of the business or part of it involves holding a licence (eg a liquor licence) the Seller should ensure that the Buyer is likely to be granted a new licence or have the existing one transferred.	The Buyer will need to ensure that the Seller has all the necessary licences to operate the business and that the Buyer will be granted a new licence or a transfer of the existing one. Completion of the contract must be conditional on that happening.
GST	
No GST is payable if the business is sold as a 'going concern'. The Tax Office has strict rules about when a sale is of a 'going conern'. Essentially, the vendor must transfer everything necessary for the purchaser to immediately operate the business including the premises and maybe even key employees.	