Buying (Or Selling) A Small Business
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Although businesses often have no actual Real Estate attached, they are usually offered for sale through Real Estate agents. Of the 1,300 Realtors operating in the Anchorage area, about 100 of us actually deal with commercial transactions. This is because the sale of a business involves completely different skills to Real Estate. Commercial licensees will either have a professional business/accounting background or the CCIM designation.

Real Estate is, by definition, the ground (lot) plus anything permanently attached to it (buildings, trees, plants and shrubs). In turn, permanent fixtures in the building are Real Estate because they are "attached" to the building which is "attached" to the ground.

Sometimes a business for sale includes the land and buildings but, in 90% of cases, the business operates in leased premises. So what are you buying when you purchase a business? When you buy a business it is critical to identify what it is you acquire for the money. It is also vital to allocate the purchase price individually over each of those items.

When you buy a business, whether it be a grocery store, restaurant, factory or wholesale flower business or such, there will be machinery or equipment, fixtures, inventory of materials or product, maybe vehicles, office equipment and furniture. These are obvious "visible" assets.

However, you are also buying some "invisible" items. The ongoing business itself has value, or "goodwill". There is the right to take over the lease and perhaps accounts receivable (or payable) which you may assume. There is the list of clients which, arguably, is part of the goodwill value.

An example of the breakdown of price in the business acquisition might look as follows:-

Machinery and Equipment	60,000
Furniture and Fixtures	20,000
Office Equipment	10,000
Motor Vehicles	15,000
Inventory of Supplies	5,000
Inventory of Stock in Trade	30,000
Accounts Receivable	8,000
Accounts Payable	(3,000)
Goodwill	4,000
Covenant not to compete	1,000
Total Purchase Price	$150,000

TAX IMPLICATIONS: It is not only critical to establish "what you get" for the money, but also to allocate the purchase price in a favorable manner.

Equipment, fixtures, vehicles and office equipment can be written off, for tax purposes, over 7 years or less. Goodwill and the covenant not to compete are "intangible" and can only be written off over 15 years. Obviously, it pays the buyer to maximize the value of the most depreciable assets and minimize the intangibles.

The Seller will want to do the opposite since the gain on equipment sale will be taxed as "recovered depreciation" at normal tax rates, whereas the goodwill will be classed as a "capital gain" at a lower rate. Therefore, while you may agree to $150,000 for the business, you may disagree over how it is allocated. This must be resolved in the purchase contract as the IRS looks very unfavorably on two parties reporting the items differently.

COVENANT NOT TO COMPETE: Always place some monetary value on the Seller's agreement not to compete in a similar business for, say, 3 years. The placing of a dollar figure on it, however small, makes it legally enforceable.

UCC SEARCH: When you purchase the Real Estate there is always a "title" search to establish what "liens" may be recorded against the property. With a business, there can also be liens against the equipment, vehicles, fixtures, and also against the individuals who own the business.

A Uniform Commercial Code search (UCC) will ferret out any liens. In Anchorage, certain Title Companies can do this if they have a commercial specialty. For $30 a name, they will check the Anchorage and State Registries where these lien documents are all recorded. You must be sure to include the business name and the names of individual owners in the search.

VALUATION OF INVENTORY: Certain items such as inventory, accounts payable and receivable (if transferred with the business) do not have a static value. They change from day to day. Thus, your contract may state $30,000 for inventory of stock in trade but, on the day of closing, it could be $25,000 or $35,000.

For this reason, you must either have the seller guarantee a minimum value for inventory at closing, or agree to an independent valuation the night before closing. There are professional "inventory counters" who can perform this task fast and relatively inexpensively.

OTHER FACTORS: It is also a good idea to obtain an agreement, in the contract, for the seller to train you for the business. Most sellers will spend 2-3 weeks (part-time) with you for training, because they are proud of their knowledge. No dollar value needs to be put on this in the agreement.

CONCLUSION: Buying a business can be lots of fun but consulting an accountant, an attorney, and using a commercially experienced Realtor to represent you, are most important.