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# Purchase Price Allocation For Tax Purposes

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# Financial Objectives

- ◆ Seller – To maximize the AFTER TAX proceeds from the sale.
- ◆ Buyer – To minimize the consideration relative to the after tax cash flow of the future operations

# Stock Acquisition Issues

- ◆ All liabilities are assumed
- ◆ No change in asset basis – tax basis carries over
- ◆ “Old” depreciation continues over remaining life
- ◆ Double taxation if assets sold (C Corporations)
- ◆ Allocation to non-compete agreements and/or personal goodwill
- ◆ Future compensation to seller
- ◆ Ease of transfer of licenses and contracts
- ◆ Continuation of existing accounting methods

# Asset Acquisitions – Buyer's Benefits

- ◆ Ability to limit liability
  - ◆ Only identified liabilities are assumed
    - ◆ No hidden liabilities assumed
      - ◆ Federal tax audits
      - ◆ States
      - ◆ Other
  - ◆ Transferability of Contractual Rights

# Asset Acquisitions – Buyer’s Benefits

- ◆ Ability to select “new” accounting methods
  - ◆ Overall
  - ◆ Depreciation
  - ◆ Recurring item elections
  - ◆ Inventory Valuation

# Asset Acquisitions – Buyer's Benefits

- ◆ Fresh start asset basis
  - ◆ Fixed Assets are value at current FMV and new depreciation is started
  - ◆ Allocation of real property value based on cost segregation
  - ◆ Amortization of identified intangibles with limited life over remaining life (excludes non-compete)
  - ◆ 15-year amortization of intangibles including non-compete agreements

# IRS Reporting For Asset Based Transactions

- ◆ Need to Comply With IRC Section 1060
  - ◆ Parties allocation is binding unless **IRS** determines it is not appropriate.
  - ◆ Both Parties Need To File Form 8594
  - ◆ Disclosure of other related agreements (employment, non-compete, management, etc.)
  - ◆ Allocation based on residual method

# RESIDUAL METHOD

- ◆ Step One - Value all identified assets
- ◆ Step Two – Determine amount to be allocated (Contract price including non-specific transaction costs)
- ◆ Step Three – Assign to respective classes of assets in the following order
  - ◆ Class I - Cash
  - ◆ Class II - Marketable Securities
  - ◆ Class III – Market to Market Assets & Accounts Receivable
  - ◆ Class IV – Inventory
  - ◆ Class V – Assets Not Otherwise Classified
  - ◆ Class VI – Section 197 Intangibles other than Goodwill and Going Concern
  - ◆ Class VII – Goodwill and Going Concern Value (Residual)
- ◆ Step Four – Adjust for specific transaction costs as required

# Asset Acquisitions

- ◆ Ability to use single level taxation entity while still continuing liability protection (S Corporation or Limited Liability Company)

# Asset v Stock Acquisitions – Tax

Are asset purchases more valuable than stock acquisitions?

# Asset v Stock Acquisitions – Tax

Are asset purchases more valuable than stock acquisitions?

IT DEPENDS

# VALUATION FOR TAX PURPOSES

## ALLOCATIONS

- ◆ Fair Market Value
  - ◆ Hypothetical Parties
  - ◆ At Arms Length
  - ◆ Neither under compulsion to act
  - ◆ With full awareness of the facts



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# IMPACT OF ALLOCATION TO SELECTED ASSETS

# Tax Treatment of Acquired Assets

## Asset Acquisition

- ◆ Accounts Receivable
  - ◆ Seller - Ordinary gain or loss to the extent the allocated value differs from tax basis
  - ◆ Buyer – Ordinary gain or loss to the extent collection differ from allocated value
- ◆ Inventory
  - ◆ Seller – Ordinary gain or loss
  - ◆ Buyer – Capitalize – can impact earnings in first year.

# Tax Treatment of Acquired Assets

## Asset Acquisition

### ◆ Real Estate

#### ◆ Land

- ◆ Seller – Capital Gain (15%)
- ◆ Buyer – Capitalized – No write-off

#### ◆ Building

- ◆ Seller – Recapture / Capital Gain (25% - 15%)
- ◆ Buyer - Depreciation

# Tax Treatment of Acquired Assets

## Asset Acquisition

- ◆ Personal Property
  - ◆ Seller – Section 1245 Ordinary Income Recapture or Section 1231 Loss
  - ◆ Buyer – Capitalize and depreciate over useful life (fresh start)

# Tax Treatment of Acquired Assets

## Asset Acquisition

- ◆ Goodwill
  - ◆ Seller – Capital Gain
  - ◆ Buyer – Capitalize and amortize over 15 years
- ◆ Non-Compete Agreement
  - ◆ Seller – Ordinary Income
  - ◆ Buyer – Capitalize and amortize over 15 years

# Tax Treatment of Acquired Assets

## Asset Acquisition

- ◆ Consulting / Employment Agreement
  - ◆ Seller – Ordinary income subject to FICA
  - ◆ Buyer – Current deduction

# Tax Treatment of Acquired Assets

## Asset Acquisition

- ◆ Intellectual Property With Legal Life
  - ◆ Seller – Capital Gain
  - ◆ Buyer – Capitalize and amortize over legal life
- ◆ Other Intangibles
  - ◆ Seller – Capital Gain
  - ◆ Buyer – Capitalize and amortize over 15 Years

# Intellectual Property and Other Intangibles

## ◆ 15 Year Amortization

- ◆ Know How
- ◆ Secret Formula
- ◆ Goodwill
- ◆ Going Concern
- ◆ In Place Staffing
- ◆ Product Design
- ◆ Package Design
- ◆ Internet Site

## ◆ Legal Life Amortization

- ◆ Leasehold Interest
- ◆ Contractual Rights
  - ◆ Customers (\*)
  - ◆ Suppliers
  - ◆ Labor / Union
- ◆ Trademark
- ◆ Patent
- ◆ Favorable Financing

\* Could give rise to ordinary income.

# Miller Cooper & Co. Ltd.

## Merger & Acquisition Services

- ◆ Evaluate potential targets
- ◆ Propose and negotiate deal terms
- ◆ Perform due diligence
- ◆ Provide competitive intelligence research
- ◆ Assist with business plans
- ◆ Prepare financing proposals
- ◆ Perform post-closing audit and true-up
- ◆ Assist in resolving disputes

# For More Information

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