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Asset Sale Case Study

Let's take the case of ABC Asset Management, which has entered into an agreement to purchase the assets of Main Street Advisors ("MSA") for a purchase price of $1,000,000. For purposes of this and all other examples, MSA is a single member limited liability company taxed as a sole proprietorship.

Scenario A: All cash at closing

The deal assumes an all-cash closing on January 1, wherein both buyer and seller agree that the price is allocated as follows:

- $10,000 for computers (assume no depreciation)
- $35,000 for furniture and fixtures (assume no depreciation all 7-year property)
- $15,000 for website and URL (unamortized basis of $5,000)
- $940,000 for goodwill (no basis for tax purposes)

> Planning Tip
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> A discussion of the installment methodology (or election out of) would encompass a separate paper in its own right; however, IRS Publication 537, Installment Sales, provides a great deal of information and insight on this topic that applies to both buyers and sellers.

All assets have been held for longer than one year, and the amount allocated to each "class" does not exceed the assets' current fair market value. This would result in a $995,000 long-term capital gain for the seller in the year of disposition ($1,000,000 purchase price less the $5,000 unamortized basis (cost) for the website and URL).

On the other side of the transaction, the buyer will acquire property that is depreciable as follows (rounded to whole dollar):

- Computers, $10,000 depreciated over 5 years ($2,000 annually)
- Furniture and fixtures, $35,000 depreciated over 7 years ($5,000 annually)
- Website and URL, $15,000 amortized over 3 years (36 months) ($5,000 annually)
- Goodwill, $940,000 amortized over 15 years (180 months) ($62,667 annually)
- Employment agreement[1]
- Consulting agreement[1]
- Non-compete/non-solicit[1]

Now consider that while the buyer has used $1,000,000 of after-tax dollars to make the purchase, he or she will receive an annual deduction based upon the following amounts and time frames:

TAX DEDUCTION	YEARS
$74,667	... in years 1 – 3
$69,667	... in years 4 – 5
$67,667	... in years 6 – 7
$62,667	... in years 8 – 15

Scenario B: Fixed price paid / Fixed number of years to pay

Now, we can add another layer of complexity to the deal by adding a provision in which the purchase price is paid over five years, or $200,000 each year. In this situation, the total purchase price would be depreciated and amortized for a period of 20 years and could span longer if the transaction occurs midyear.

> Planning Tip
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> For reporting purposes, IRS Publication 544, Sales and Other Dispositions of Assets, provides a valuable resource for both buyers and sellers to become familiar with the tax rules and the reporting of gains or losses from a transaction.

[1]Negotiated separately and addressed in the fifth and final article of this series

This information likely does not address the implications of each specific transaction. Please be aware that this information is intended to provide an overview only and is not a substitute for specific transaction guidance from an attorney, certified public accountant, enrolled agent or other subject matter expert. For specific transactional related advice, please consult with your own tax and/or legal counsel.

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