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October 15, 2013

## **ABC'S OF SELLING OR BUYING A PRIVATELY OWNED BUSINESS:** *An Outline for Every Seller and Buyer*

This is the third of three Newsletters that address the process of buying or selling a privately held business. The first two installments were:

- I. Pre-Contract Considerations
- II. The Contract of Sale

### **PART III: THE CLOSING AND POST-CLOSING CONSIDERATIONS**

In this Newsletter we address the following subjects concerning the process of closing a purchase/sale transaction and the post-closing follow up:

1. Face to Face Closing vs. Electronic Document Exchange
2. Pre-Closing
3. Bank Check vs. Wired Funds
4. Closing Inventory
5. Insurance
6. Sales Tax Collection and Notices
7. Post-Closing Escrows
8. Bill of Sale and Other Title Transfer Documents
9. Further Assurances

1. Face to Face Closing vs. Electronic Document Exchange When the term “closing” is applied to a purchase/sale transaction it is a reference to the process by which: (A) the seller delivers documents of title to the buyer; (B) the buyer or the buyer’s bank delivers funds or documents to satisfy the buyer’s purchase price obligation; and (C) the parties sign and deliver related documents that arise from the transaction (e.g. Employment Agreements; Restrictive Covenant Agreements; Officers’ Certificates; Lease Assignments; Security Documents; and the like).

Until sometime in the mid-2000s the “closing” generally took place in a lawyer’s conference room and was attended by the buyer’s and seller’s principals and their lawyers. If the transaction was financed by a bank, the bank’s representatives and its lawyers would also attend, and the closing would likely take

place at the bank or the bank's attorney's offices. The traditional "face to face" closing often caused parties to incur substantial travel and lodging costs when parties and/or attorneys had to travel to the closing.

However, sometime around the middle of the last decade, attorneys and others became more adept with electronic equipment and determined that transactions (both purchase/sale and financing) could be accomplished from multiple remote locations by employing e-mail and PDF copies of documents. The process is typically as follows: (A) documents are signed in advance to be held in escrow by the attorneys; (B) PDF copies of signed documents are exchanged by e-mail; (C) funds are transferred electronically; and (D) signed original documents are exchanged ...generally by overnight carrier.

## 2. The "Pre-Closing"

There are factors that cause the closing of certain purchase/sale transactions to require more time than others. These may include larger numbers of parties and their representatives; complex securitization processes; parallel financing transactions; unavailability of some principal parties; last minute changes and the like. Recognizing these time consuming factors, the attorneys will often agree to conduct a "pre-closing" prior to the actual closing.

For an all-electronic closing, the pre-closing typically proceeds as follows: (A) the attorneys confirm the parties' agreement to final language of all necessary documents; (B) "signature ready copies" of all necessary documents are exchanged by e-mail; (C) the necessary parties sign separate counterparts of the "signature ready copies"<sup>1</sup> and deliver them to the party's own counsel; and (D) the attorneys exchange executed signature pages, which are held in escrow until the closing is finalized.

For a closing that is at least partially face to face, the above procedures are generally followed except that hard copy documents rather than e-mailed PDFs are employed for those portions of the process that are conducted in person.

Sellers, borrowers and/or other payees will typically provide wire transfer instructions and financial institution contact information as part of the pre-closing process.

Also, in some complex transactions where financing is involved, the closing may be broken down into three segments: (A) purchase/sale pre-closing; (B) financing pre-closing; and (C) combined closing of purchase/sale and financing.

3. Bank Checks vs. Wired Funds In a face to face closing with no active bank participation, the parties have two choices for the payment vehicle: (A) a check, usually a cashier's check or (B) wire transfer. While the intuitive choice might be wire transfer, that may not be the best choice in all cases. The obvious benefit of wire transfer is that the recipient obtains liquid funds a day or two sooner. This can be valuable when interest rates are high and the purchase price is substantial. However, the following scenarios have arisen all too often in connection with wire transfers. In one scenario, the payee bank is a huge financial services organization with many departments and offices and the funds are actually received by a different department or office than the anticipated one. As a result, a room full

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<sup>1</sup> Agreements for these transactions will often include a clause which expressly provides that parties may sign separate counterparts of the same document.

of attorneys must monitor the situation for several hours until the funds are located. A variation on this scenario occurs when the closing is not completed until sometime in the afternoon and it is unclear as to whether the funds will or will not be received and/or credited on the same day. In either event, the parties may incur substantial legal fees in connection with the attorneys working out the procedures to confirm payment and sometimes for just waiting around. In many cases this expense could exceed any extra interest and the seller would have been better served by a cashier's check.

In an electronic closing, payment is almost invariably made by wire. However, in an electronic closing the "missing funds" expenses described above will presumably be eliminated or greatly reduced since the attorneys are all in their own offices and can work on other matters while the "missing funds" are tracked down.

4. Closing Inventory In most cases, the parties will want the target company to continue doing business to the extent possible, right up to and often through the closing date. In the sale of a product business the Asset Purchase Agreement will often make the purchase price dependent on the inventory value as of an agreed upon point in time at or around the closing date. Several different approaches can be applied to the inventory process, including: (A) conduct a full count inventory on the closing date; (B) conduct a full count inventory several days before the closing, followed by a closing date adjustment based on sales records for the several days between that inventory and the closing; or (C) conduct the inventory right after the closing when the target is controlled by the buyer. In any of these cases, a portion of the purchase price may be held in escrow to be returned to buyer if the inventory falls short of agreed upon expectations.

5. Buyer's Insurance Whenever the closing finally does come to fruition, insuring the purchased assets (if an asset deal) or all of the target's assets (if a stock deal) will become the buyer's responsibility. In most asset deals, at the conclusion of the closing the seller's insurance may cease covering the purchased assets and the buyer must have insurance in place to protect the buyer's interests in the event of a casualty loss. This concern applies not only to property damage coverage, but across the board to the various other types of casualty insurance that a business will carry, such as general liability; products liability; workers compensation; directors and officers liability; employee practices; etc.

Assuming that the target will have employees after the closing, the buyer must also consider group health coverage...particularly with the Affordable Care Act ("Obamacare") on the horizon.

If the buyer will be assuming sponsorship of the seller's retirement plan, it may consider fiduciary insurance covering the plan trustees following the closing.

For these and several other reasons, we recommend that buyers cause their insurance advisors to become involved in the transaction early in the process. One way to do this is to provide the insurance advisor an early draft of the contract, along with a description of the buyer's plans for operation of the target company after the closing. This way the insurance advisor can help make sure that all necessary and/or desirable coverage is in place when the target or its assets pass to the buyer.

## 6. Sales Tax Collection and Notices

Certain states, such as New York, impose a tax on certain retail sales. The New York State Department of Taxation and Finance (“NYS”) summarizes this obligation:

Sales of tangible personal property are subject to New York sales tax unless they are specifically exempt. Sales of services are generally exempt from New York sales tax unless they are specifically taxable.<sup>2</sup>

A sale of tangible personal property will generally be “specifically exempt” when it is a “sale for re-sale.”<sup>3</sup> Thus, regular sales by companies that manufacture and/or distribute tangible personal property (as opposed to retailers) will often be exempt from New York State sales tax.

When a New York target is required to collect sales tax in the regular course of its business (for example, most retail product sellers and some service providers) certain procedures should be followed when that target’s assets are sold. In such cases applicable law<sup>4</sup> requires the purchaser to give notice of the sale to NYS at least ten days prior to the transfer and NYS is required to respond within 90 days. If the purchaser fails to so notify NYS, or if NYS notifies the purchaser that sales tax is due, the purchased assets will become subject to a first priority lien in favor of NYS and to possible penalties. If the purchaser gives the required notice and NYS fails to notify the purchaser that there is tax claim within that 90 day period, then the assets will become free and clear of the NYS lien.

Also, even if the target company is not required to collect sales tax in the ordinary course of its business, in an asset sale attention must be paid to a sales tax liability that may arise as a result of the asset sale itself. For example, a New York service company will generally not collect sales tax in the ordinary course of business. Therefore, one might assume that no sales tax comes due when the assets of the business are sold. Such assumption might well be wrong.

When such a service provider sells its assets, the conveyance will often include tangible items that are not sold in the ordinary course of the target’s business. These would include furniture, fixtures and equipment that are used, and/or supplies that are consumed, in operating the target’s business. Those assets will be subject to sales tax when transferred as part of an asset sale. The Asset Purchase Agreement will generally identify the portion of the total purchase price that is allocated to such taxable assets and the seller is required to collect the applicable sales tax and to report and remit same to NYS.<sup>5</sup>

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<sup>2</sup> See NYS Department of Taxation and Finance; Tax Bulletin ST-740 (TB-ST-740); June 17, 2010 at: [http://www.tax.ny.gov/pubs\\_and\\_bulls/tg\\_bulletins/st/quick\\_reference\\_guide\\_for\\_taxable\\_and\\_exempt\\_property\\_and\\_services.htm](http://www.tax.ny.gov/pubs_and_bulls/tg_bulletins/st/quick_reference_guide_for_taxable_and_exempt_property_and_services.htm)

<sup>3</sup> See NYS Tax Law Sec. 1105 and Resale Certificate Form ST-120

<sup>4</sup> See NYS Tax Law Sec. 1141 (c) and Form AU-196.10

<sup>5</sup> This type of isolated sale of tangible personal property is known as a “casual sale” and is reported to NYS Department of Taxation and Finance in the “Seller’s Report of Sales Tax Due on a Casual Sale” Form ST-131.

## 7. Closing Escrows

While issues often arise at or before a scheduled closing that could cause a postponement, the parties may wish to close despite these issues. These competing interests are often resolved by escrow arrangements agreed to at the time of closing.

For example, as described in the preceding section of this Newsletter, compliance with NYS Sales Tax Law may delay the closing for up to 90 or more days. If the parties do not wish to suffer that delay, they may agree to close without waiting for sales tax clearance. To secure the purchaser against sales tax liability assessed by NYS after the closing, the buyer may insist that a reasonable portion of the purchase price be held in escrow for an agreed time period following the closing.

Similarly, parties to business sale transactions may agree to place a portion of the purchase price in escrow for any number of other purposes, such as where the seller has failed to give the purchaser adequate assurances as to the absence of liabilities<sup>6</sup> or when the value of assets to be conveyed may fall short of projections.<sup>7</sup>

Alternatively, in cases where the purchase price will be paid over time, the buyer may rely on the unpaid balance as a *de facto* escrow. However, one word of caution: a well drafted Promissory Note may prohibit the buyer from off-setting obligations in this way. All things being equal, the buyer will usually be better protected by a formal escrow arrangement.

## 8. Bill of Sale; Stock Power and Other Title Transfer Documents

### A. Basic Transfer Documents: Bill of Sale and Stock Power

The fundamental difference between a stock sale and an asset sale manifests itself in the piece of paper employed to transfer title. In a stock sale, the instrument used to transfer shares representing ownership of the target is a Stock Power. This is a one page instrument signed by each selling shareholder which evidences that seller's act of transferring shares to the buyer. A sample Stock Power is attached as Rider A. In an asset sale, the basic instrument used to transfer title to the assets being sold is a Bill of Sale. This too is a one page instrument that evidences the seller's act of transferring the involved assets to the buyer. A sample Bill of Sale is attached as Rider B.

### B. Domain Name and Website

In the past, asset deals could for the most part be effectuated by a Bill of Sale. However, that process has been complicated by many factors, including the advent of electronic commerce. Today, virtually every substantial business owns a domain name or names and operates a website or websites. The simple Bill of Sale often will not, in and of itself, be sufficient to effectuate a meaningful transfer of these assets. The buyer may also require a separate agreement for the sale of domain names and websites. After the closing, the buyer will submit that agreement, along with the Bill of Sale, to the appropriate web host

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<sup>6</sup> For example, an escrow may be created to secure the purchaser against claims of creditors that are not asserted until after the closing.

<sup>7</sup> For example, an escrow may be created to secure the purchaser against short falls in items like inventory or receivables.

and domain name depository along with any other documentation reasonably requested by the hosting organizations.

C. Intellectual Property

If the target company owns intellectual property registrations, additional procedures must be followed to effectively transfer record ownership of the registrations to the buyer. Companies that create or use copyrightable designs or music, computer software, and the like will often own multiple United States Copyright Registrations. Likewise, companies that have numerous product lines will often own United States Trademark Registrations. The procedures employed to transfer record ownership of these valuable assets are beyond the scope of this Newsletter. Suffice it to say that such transfers may often be most efficiently and effectively accomplished by engaging intellectual property counsel to process and file the paperwork.

D. Real Property

In an asset deal, if the target owns or leases real property and the buyer wishes to acquire the title or leasehold, additional processes must be undertaken. If the seller or an affiliated party owns the real estate, it must be sold in much the same way as any other commercial real estate transaction. If the seller leases the real estate, there are at least three ways to proceed: (A) the lease may be assigned to the buyer or (B) seller may keep the leasehold and sub-let the property to the buyer, or (C) the buyer and landlord may enter into a new lease. The choice will often depend, in the first instance, on the restrictions in the lease governing assignments and sub-lets. In many cases, the buyer and landlord may each, for its own purposes, wish to enter into a new lease. For example, a buyer will often want a longer lease term than the period that remains in the existing lease term; likewise, the landlord may want an increase in rent and/or security, or other changes that benefit the landlord. Practically speaking, a knowledgeable landlord can usually impede the assignment or sub-let approval process sufficiently to force the buyer to agree to a new lease.

E. Further Assurances

Notwithstanding the best efforts of the buyer and its counsel, the buyer may encounter situations where a necessary third party refuses to effectuate the transfer of a particular asset without further paperwork. For example, a telephone provider may not acknowledge the buyer's right to the seller's phone and fax numbers without the seller signing some unanticipated phone company form.

In order to obligate the seller to cooperate with such endeavors after the closing, the Asset Purchase Agreement or Stock Purchase Agreement should include a "Further Assurances" clause which typically contains language like the following:

Further Assurances The parties hereto shall undertake and perform all such further acts and shall execute and deliver all such further instruments and documents as any other party hereto may reasonably request in order to carry out the intent of the parties and accomplish the purpose of this Agreement and the consummation of the transactions contemplated hereby

F. Other Closing Items

And finally, the buyer must make sure to take possession of numerous mundane items such as the keys (premises, vehicles, file cabinets, etc.) and the codes (alarm systems, anything with a user name and password, etc.).

**RELATED NEWSLETTERS**

As indicated above, this is the third of three Newsletters that address the process of buying or selling a privately held business:

- I. Pre-Contract Considerations
- II. The Contract of Sale
- III. The Closing and Post-Closing Considerations

If you wish to access either of the prior Newsletters you can do so through the following links:

- I. Pre-Contract Considerations

<http://waxmanlaw.com/wp-content/uploads/2013/04/Newsletter-I-Pre-Contract.pdf>

- II. The Contract of Sale

<http://waxmanlaw.com/wp-content/uploads/2013/04/NewsletterIIContractofSale.pdf>

**CONCLUSION**

No two purchase and sale transactions are exactly alike. Nevertheless, most will involve many of the issues and/or procedures described in these three Newsletters. We hope that they will help you to ask the right questions, select the appropriate advisors and make the best decisions.

If you have any questions about these Newsletters or business acquisitions in general, or any other issues involving business or corporate law, please contact Richard Waxman at:

[rwaxman@waxmanlaw.com](mailto:rwaxman@waxmanlaw.com)

In case you have trouble reading this e-mail, we have attached a PDF copy of this Newsletter in the banner of the covering e-mail.

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RIDER A

**STOCK POWER**

**FOR VALUE RECEIVED**, Alfred E. Newman hereby assigns and transfers to Melvin Cowznofski Twenty (20) Shares of the Common Capital Stock of Alfred E. Newman LLC (the "Corporation") standing in his name on the books of the Corporation, represented by Certificate No. 1, and hereby irrevocably constitutes and appoints Richard H. Waxman as attorney to transfer the said Stock on the books of the Corporation, with full power of substitution in the premises.

Date: November 3, 2013

IN PRESENCE OF:

\_\_\_\_\_  
ALFRED E. NEWMAN

\_\_\_\_\_  
Witness

RIDER B

**BILL OF SALE**

**BILL OF SALE** made by Alfred E. Newman Inc. (“Seller”) pursuant to the June 15, 2013 Asset Purchase Agreement (the “Agreement”) between Seller and Melvin Cowznofski LLC (“Buyer”). Capitalized terms used herein shall have the meanings ascribed to such terms in the Agreement.

In accordance with and subject to the Agreement, for good and valuable consideration, including the payment by the Buyer of the Purchase Price stated in the Agreement, the receipt of which Seller hereby acknowledges, Seller hereby sells, conveys, transfers, assigns and delivers to Buyer, its successors and assigns, forever, all of the Assets in Schedule A attached hereto and made a part hereof, free and clear of all claims, liens, encumbrances and rights of any other person or entity.

Dated: June 15, 2012

ALFRED E. NEWMAN INC.

By \_\_\_\_\_  
ALFRED E. NEWMAN, President