# Buying an existing business

by Kerry Fox, Augustine Bater Polowin LLP, Barristers & Solicitors

If you are interested in purchasing an existing business, you might be working with either a real estate agent or a business broker. Once you've decided on the business that you want to purchase and the purchase price, there are a number of factors to consider when it comes to drafting the Agreement of Purchase and Sale and completing the transaction.

Keep in mind that the written Agreement of Purchase and Sale represents the *entire* agreement between the parties and anything that is important to the deal needs to be included in this Agreement.

Here are some things to keep in mind:

## How are you allocating the purchase price?

Once you have agreed upon the price, you need to decide how the purchase price will be allocated. The purchase price is allocated to goodwill, equipment, and leasehold improvements (and, sometimes, the lease itself). The allocation of the purchase price is important because it allows you to allocate part of the price to items which can be depreciated quickly such as leasehold improvements or equipment. From a tax perspective, this can be advantageous. Usually, it is in the buyer's interests to allocate as much as possible of the purchase price to leasehold improvements. On the other hand, from the seller's perspective, it is preferable to allocate as much as possible to goodwill. Depending upon the type of business you are purchasing, it is advisable to speak with an accountant about the best way to allocate the purchase price in your Agreement.

## Will the landlord consent to you assuming the lease?

For some businesses, the value of the business includes a favourable lease in a good location. If you are purchasing a business on leased premises, you will need to obtain the consent of the landlord prior to assuming the existing lease. This is usually included as a condition of the Agreement. The type of information that a landlord will want before agreeing to an assignment of a lease will vary but, at a minimum, they will want credit information and information about your experience running a business.

## What should you look for in a lease?

The complexity of a lease will vary depending upon whether your business is located in a major shopping centre or a small commercial building. In reviewing a lease, pay attention to how many years are left on the lease prior to renewal, and whether there is a right of renewal. Ideally, what you want is a right to extend the lease, as opposed to an option to renew. An option to renew is only a right to negotiate a new lease, with new terms and provisions. It is more favourable to have a commitment that the lease can be *extended* upon the same terms and conditions as contained in the original lease.

If the end of the term is coming up on the existing lease, it might be better to negotiate a new lease altogether.

Most leases are 'net' leases meaning that in addition to rent per square footage, you also pay to the landlord additional rent such as property taxes, and operating costs such as utilities, insurance, maintenance, repair & property management. You need to know the amount of these additional costs since you will be paying for them. Quantifying the additional rent will help you decide whether the lease is affordable based upon the type of business you will be operating at that location.

**Employees**

It is important to ascertain whether the business you are buying has any part time or full time employees. If so, you will become liable as a successor employer for obligations to these employees, including salary, vacation pay, unemployment insurance premiums and worker's compensation premiums. Because of these obligations, and the difficulty of determining the full extent of your obligations as a prospective purchaser, you may not want to retain any employees, and hire your own employees after the purchase transaction is completed. If you are buying a small business, it can be preferable to include a provision in the Agreement which requires the vendor to terminate all employees before closing.

**GST**

If you don't already have one, you will need to obtain a GST number for the closing. When you are purchasing all, or substantially all, of the assets of a business, you are entitled to make an election to defer payment of GST. This election can only be made if the buyer is a GST registrant.

**Warranties**

You need to have adequate warranties included in the Agreement of Purchase and Sale to ensure that the vendor has paid any GST and provincial sales taxes which are owing by the business, and that there are no other liabilities attaching to the business. It is always advisable to obtain a retail sales clearance certificate confirming that provincial sales taxes are up-do-date (although, if it is a short closing, some purchasers will opt to accept a written warranty that retail sales tax has been paid). You will also want warranties that all books and records produced during your due diligence period are accurate and fully disclose all financial matters.

Since a warranty is merely a legal promise by the vendor, it is always best to have an accountant review the financial records of the business before the Agreement is finalized.

**Non-competition clauses**

Often, purchasers will want to negotiate a covenant with the vendor limiting the vendor's ability to compete with them after closing in a similar business. If you are buying a bakery, you don't want the vendor opening up shop a few doors down after the closing. If the vendor will agree to a non-competition covenant on closing, this possibility is eliminated.

Non-competition covenants can be useful but, in order to be enforceable, they cannot be overly restrictive. It might be reasonable to restrict the vendor from opening up a similar business for 1 to 5 years following the closing, and for this restriction to operate within a radius of 1 to 5 kilometres surrounding the current business location, depending upon the type of business being sold.

For further information, please contact:

**Kerry Fox, LL.B.**
Augustine Bater Polowin LLP
Barristers & Solicitors
Suite 1100, 141 Laurier Avenue West
Ottawa, ON K1P 5J3

p (613) 569-9500 ext. 30
f (613) 569-9522