CLIENT ALERT

METZ LEWIS BRODMAN MUST O'KEEFE LLC

ASSET PURCHASE AGREEMENT

When buyers and sellers enter into an asset purchase agreement, Internal Revenue Code Section 1060 requires that the buyer and seller agree to the allocation of the purchase price to the various categories of assets purchased. The allocation is documented on Form 8594.

The recent Tax Court decision in Peco Foods , affirmed by the Eleventh Circuit, indicates that significant attention must be given to how the allocation of the purchase price is documented in the agreement. In this case, the buyer and seller included a detailed description of the assets purchased and the purchase price allocation. In several provisions in the agreement and related schedules, reference was made to "buildings." The buyer filed tax returns using the agreed upon allocation. Later, the buyer had a cost segregation study done. The study determined that a significant amount of the purchase price originally allocated to buildings (39 year life property) in the agreement could be allocated to shorter lived tangible personal property. The buyer filed for an accounting method change with the IRS to use the shorter lives. The Internal Revenue Service challenged this change. The IRS position was that the very specific allocation in the agreement was binding on both parties and references to "buildings" indicated a specific intent that this allocation provided in the agreement was to the longer lived assets.

Upon appeal, the Tax Court agreed with the IRS.

In the planning context, there may be an opportunity for the parties to not be as specific in the agreement as the parties in the Peco Foods case.

If a cost segregation study is contemplated by the buyer, this planning concept should be considered early in the asset purchase process so as to have the allocation based on the asset allocation classes.

Further, even though Section 1060 requires that an allocation be done, Form 8594 is broad in the asset allocation classes.

Class V assets include furniture, fixtures, equipment, land and buildings. The specific allocation to each asset in the Class is not required in this Form 8594 reporting. This approach may allow for future flexibility in the specific asset allocation.

However, the buyer and seller should consider this important purchase price allocation issue before the agreements are signed.

Contact Larry S. Blair of Metz Lewis Brodman Must O'Keefe at 412-918-1123 for more information.

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