M&A transactions: Avoid surprises from the IRS

If you're considering buying or selling a business — or you're in the process of a merger or acquisition — it's important that both parties report the transaction to the IRS in the same way. Otherwise, you may increase your chances of being audited.

If a sale involves business assets (as opposed to stock or ownership interests), the buyer and the seller must generally report to the IRS the purchase price allocations that both use. This is done by attaching IRS Form 8594, "Asset Acquisition Statement," to each of their respective federal income tax returns for the tax year that includes the transaction.

What's reported?

When buying business assets in an M&A transaction, you must allocate the total purchase price to the specific assets that are acquired. The amount allocated to each asset then becomes its initial tax basis. For depreciable and amortizable assets, the initial tax basis of each asset determines the depreciation and amortization deductions for that asset *after* the acquisition. Depreciable and amortizable assets include:

- Equipment,
- Buildings and improvements,
- Software,
- Furniture, fixtures and
- Intangibles (including customer lists, licenses, patents, copyrights and goodwill).

In addition to reporting the items above, you must also disclose on Form 8594 whether the parties entered into a noncompete agreement, management contract or similar agreement, as well as the monetary consideration paid under it.

IRS scrutiny

The IRS may inspect the forms that are filed to see if the buyer and the seller use different allocations. If the IRS finds that different allocations are used, auditors may dig deeper and the investigation could expand beyond just the transaction. So, it’s in your best interest to ensure that both parties use the same allocations. Consider including this requirement in your asset purchase agreement at the time of the sale.

The tax implications of buying or selling a business are complicated. Price allocations are important because they affect future tax benefits. Both the buyer and the seller need to report them to the IRS in an identical way to avoid unwanted attention. To lock in the best postacquisition results, consult with us before finalizing any transaction.