Mergers and Acquisitions: Federal Income Tax and Virginia Corporate Law Considerations

Louis A. Mezzullo
MERGERS AND ACQUISITIONS: FEDERAL INCOME TAX
AND VIRGINIA CORPORATE LAW CONSIDERATIONS

Louis A. Mezzullo
Mezzullo & McCandlish
Richmond, Virginia

(October 1, 1990)
MERGERS AND ACQUISITIONS: FEDERAL INCOME TAX
AND VIRGINIA CORPORATE LAW CONSIDERATIONS

Louis A. Mezzullo
Mezzullo & McCandlish
Richmond, Virginia

(October 1, 1990)

TABLE OF CONTENTS

I. INTRODUCTION ........................................ 1
   A. General ............................................. 1
   B. Tax Considerations: In General ...................... 3
   C. Corporate Law Considerations: In General .......... 11

II. MERGERS ................................................ 12
   A. Nontaxable Mergers (A Reorganizations): Requirements ............................................. 12
   B. Taxable Mergers ...................................... 14
   C. Tax Consequences to the Parties ..................... 14
   D. Corporate Law Considerations for a Merger ........ 15
   E. Practical Considerations ............................. 19

III. STOCK EXCHANGES ....................................... 21
   A. Nontaxable Share Exchanges (B Reorganizations): Requirements ............................................. 21
   B. Taxable Share Exchanges ............................. 22
   C. Tax Consequences to the Parties ..................... 22
   D. Corporate Law Considerations for a Share Exchange ............................................. 23
   E. Practical Considerations ............................. 24

IV. ASSET ACQUISITIONS ..................................... 25
   A. Nontaxable Asset Acquisitions (C Reorganizations): Requirements ............................................. 25
I. INTRODUCTION

A. General.

1. The phrase "mergers and acquisitions" generally refers to the combination of two or more corporate businesses.

   a. Usually a mergers and acquisitions transaction will involve one corporation (the buyer) acquiring either more than 50 percent of the outstanding shares or a significant portion of the assets of another corporation (the target).

2. Although this combination may take many forms, this outline will cover only three most common forms used by closely-held corporations:

   a. A true merger, whereby two or more corporations are merged into one corporation, the surviving corporation.

      (1) A consolidation is a form of merger in which two or more corporations are merged into a new corporation, so that it appears that there is no "surviving" corporation; for tax and corporate law purposes, there is no difference between a merger and a consolidation.

   b. A share exchange, whereby the buyer acquires all of the stock of the target in exchange for the buyer's stock, cash, or other property, or any combination of the three.

      (1) After the exchange, the target is a subsidiary of the buyer.

The author gratefully acknowledges the assistance of S. Brian Farmer, of Mezzullo & McCandlish, in the preparation of this outline.
(2) The new subsidiary corporation and the buyer may be later merged.

c. An asset purchase, whereby the buyer acquires some or all the assets of the target in exchange for the buyer's stock, cash, or property or any combination of the three.

(1) The target may then be liquidated (which must occur in a tax-free C reorganization), continue in existence as a holding company, or engage in a new business using the sale proceeds to purchase new assets.

3. Mergers and acquisitions can be structured as either nontaxable or taxable.

a. Even in nontaxable transactions, taxable gain will be recognized if boot is received by the shareholders of the target.

(1) Boot is cash, property, or securities (other than securities of the buyer) that are paid as part of the consideration for the acquisition of either stock or assets of the target.

(2) Securities of the buyer received by the shareholders of the target will constitute boot to the extent their face value exceeds the face value of the securities of the target given up in the exchange.

4. A mergers and acquisitions transaction must comply with the stock corporation law of the state of incorporation of both the buyer and the target.

a. This outline will describe only the requirements under the Virginia Stock Corporation Act for the three forms of transactions covered.

5. Mergers and acquisitions can also be undertaken by non-stock corporations.

a. This outline covers mergers and acquisitions involving only stock corporations.
6. The federal and state securities laws must be considered when planning for mergers and acquisitions.
   a. This outline does not cover securities laws.

7. Other areas of the law that must be considered include environmental law, antitrust laws, ERISA, labor law, and the Uniform Commercial Code (including the Bulk Sales Act).
   a. This outline does not cover these other areas of the law.

8. Careful drafting is required in connection with the documentation of a mergers and acquisitions transaction.
   a. Although this outline does not deal with drafting issues, there is a sample asset purchase agreement form attached as an appendix.

   (1) Note that the form is not meant to cover all aspects of an asset purchase; the form is designed for use in relatively straight-forward asset acquisitions and is provided to offer some idea of the types of issues that must be dealt with in any mergers and acquisitions transaction.

B. **Tax Considerations: In General.**

1. Nontaxable transactions.
   a. A nontaxable transaction, in addition to satisfying specific statutory and regulatory requirements, must also comply with three doctrines that have been developed by the courts.

   (1) **Continuity of Interest.** Continuity of interest encompasses both the continuity of the business enterprise under the modified corporate form and a continuity of ownership in the business enterprise by those persons who directly or indirectly were owners of the enterprise prior to the reorganization.
(a) Continuity of business enterprise requires that the buyer either continue the target's historic business or use a significant portion of the target's historic business assets in a business. Treas. Reg. § 1.368-1(d).

(b) Continuity of interest at the shareholder level requires that the owners of the target receive a substantial amount of equity stock in relation to the value of the property transferred to the buyer and that the equity interest be retained for a significant period of time.

i) A five-year period has been used for private letter ruling purposes. Rev. Rul. 66-23, 1966-1 C.B. 67.

ii) The courts have established a benchmark for purposes of determining whether the shareholders of the target have retained a substantial amount of equity stock in the buyer, requiring that the equity interest retained equal approximately 50 percent of the value of the property transferred to the buyer.

(2) Business Purpose. The business purpose requirement can be viewed as the flip side of a tax avoidance purpose. Although it is not clear whether the business purpose must be one of the corporation or the shareholders, there must be a nontax reason for entering into the transaction.

(3) The Step Transaction Doctrine. Under the step transaction doctrine, a series of transactions are folded into one transaction for purposes of determining the tax consequences. The step transaction doctrine may or may not help to satisfy the statutory and regulatory
requirements for tax-free reorganizations.

(a) For example, if unwanted assets of a corporation are disposed of immediately preceding a C reorganization (stock for assets), the requirement that substantially all the assets be transferred to the buyer may not be satisfied.

(b) A transaction that by itself does not qualify for tax-free treatment may be qualified as part of a series of transactions in a "creeping" reorganization.

b. The tax consequences of a tax-free mergers and acquisitions transaction are generally as follows:

(1) The buyer generally recognizes no taxable gain or loss as a result of the transaction.

(a) The buyer will recognize taxable gain or loss only if it uses property other than its own stock or securities to acquire stock or assets from the target, since a corporation does not recognize taxable gain or loss on issuance of its own stock. I.R.C. §§ 361(a) and 1032.

(b) The basis of assets received by the buyer is the same as the basis of the assets in the hands of the target, increased by any gain recognized by the target. I.R.C. § 362(b).

(2) The shareholders of the buyer generally will have no taxable gain or loss as a result of the transaction.

(a) The shareholders of an S corporation may recognize taxable gain or loss if the buyer uses property other than its own stock or securities to acquire stock or assets.
(3) The target generally recognizes taxable gain or loss if the target is liquidated as part of the reorganization and property, other than stock or securities of another corporation that is a party to the reorganization, is distributed to the shareholders of the target.

(4) The shareholders of the target will have taxable gain to the extent that they receive boot. I.R.C. § 356(a)(1).

(a) The boot will be taxed as capital gain if the distribution qualifies as a sale or exchange under I.R.C. § 302.

(b) If the distribution does not qualify for sale or exchange treatment, it will be treated as a dividend. The amount of the dividend is limited to the shareholder's ratable share of the accumulated earnings and profits of the target (and in some cases, the target and the buyer). I.R.C. § 356(a)(2).

(c) A shareholder of the target who does not receive any stock of the buyer (only possible in an A or C reorganization) will recognize gain or loss equal to the difference between the shareholder's basis in the stock of the target and the fair market value of the assets received.

2. Taxable transactions.

a. Taxable transactions are transactions that do not satisfy either the nonstatutory requirements or the specific statutory requirements for one of the types of nontaxable reorganizations.

b. The tax consequences of a taxable mergers and acquisitions transaction are as follows:

(1) The buyer will have no taxable gain or
loss on the issuance of its own stock under I.R.C. § 1032.

(a) The buyer will have taxable gain or loss if it uses other property to acquire stock or other assets of the target.

(b) The basis of the assets received by the buyer is equal to the purchase price paid to the target (presumably, the fair market value).

(2) The shareholders of the buyer will generally have no taxable gain or loss.

(a) The shareholders of an S corporation may recognize taxable gain or loss if the buyer uses property other than its own stock and securities to acquire stock or assets.

(3) The target will recognize taxable gain or loss on the sale of its assets to the buyer or on the exchange of its assets with the buyer.

(a) If the target is liquidated as part of the reorganization, it will also recognize taxable gain or loss with respect to property distributed to its shareholders pursuant to the liquidation.

(4) The shareholders of the target will recognize taxable gain or loss on the sale or exchange of their stock, regardless of whether they receive stock of the buyer or cash or other property.

(a) A shareholder of the target will also recognize taxable gain or loss if the target is liquidated to the extent that the value of the liquidation proceeds is greater or less than the basis of his or her stock.

3. Effect of recent changes in the tax law.
a. The Tax Reform Act of 1986 (TRA 86) inverted the federal income tax rates with respect to corporations and individuals, so that now corporations are generally taxed at higher rates than individuals.

b. TRA 86 also repealed the General Utilities doctrine that permitted a corporation to liquidate without incurring any taxable gain or loss with respect to property distributed to its shareholders or to sell all its assets pursuant to a plan of liquidation under I.R.C. § 337 without recognizing any gain or loss except for certain types of income.

c. TRA 86 repealed the 60 percent long-term capital gain deduction.

(1) The provisions dealing with the distinction between long-term and short-term capital gain and ordinary income were left in the Code.

(2) The distinction is still important for at least three reasons:

   (a) In a capital gain transaction the taxpayer can reduce the amount realized by his or her basis in the asset transferred for purposes of determining the amount of taxable income.

   (b) The taxpayer can use capital losses to offset capital gain without any limit, but can only use $3,000 of capital losses to reduce ordinary income in any taxable year.

   (c) A taxpayer can use the installment method of reporting income realized in a capital gain transaction.

(3) The repeal of the long-term capital gain deduction increases the tax rate on the gain realized in mergers and acquisitions transactions.

d. TRA 86 also added I.R.C. § 1060 to the Code requiring the allocation of the purchase
price in a transaction involving a sale of the assets of a trade or business.

(1) The purchase price is allocated under the residual method, which involves allocating the purchase price first to cash, then to certificates of deposit and securities, then to all other tangible and intangible assets except good will and going concern value, up to the fair market value of such assets, and then to good will and going concern value.

(2) As a consequence, any amount of the purchase price paid in excess of the fair market value of the assets that are purchased will be allocated to good will and going concern value, and will not be deductible or amortizable by the buyer.

(3) This same allocation is required under I.R.C. § 338, when the buyer in a stock purchase elects (or is deemed to elect) to treat the purchase as an asset purchase with a step-up or step-down in basis in the assets of the target, along with the recognition of gain or loss by the target, in the same manner as if the target were liquidated.

e. TRA 86 also revised the installment sale rules with respect to installment notes received by a corporation in exchange for its assets.

(1) If the corporation transfers the installment note to its shareholders pursuant to a plan of liquidation, the corporation recognizes current income to the extent of the amount of taxable gain realized in the transaction giving rise to the installment note, while the shareholders do not recognize gain with respect to the distribution of the installment note until payments are actually received under the installment note if the liquidation is completed within 12 months after the plan is adopted. I.R.C. §§ 453B(a) and 453(h)(1)(A).
f. TRA 86 also revised the rules for carryover of various corporate attributes, including net operating losses.

(1) If there is a change of ownership of more than 50 percent during a three-year period, the ability to offset taxable income with net operating losses is restricted. I.R.C. § 382.

(2) The annual limitation on the amount of net operating losses that can offset taxable income is equal to the value of the target at the time of the acquisition multiplied by the long-term tax-exempt bond rate. I.R.C. § 382(b).

4. Special problems with S corporations.

a. In order to qualify for S corporation status, a corporation must satisfy a number of requirements, two of which are important in dealing with mergers and acquisitions transactions.

(1) A corporation cannot elect S corporation status, and S corporation status will be terminated, if the corporation is or becomes a member of an affiliated group of corporations, which means that the corporation cannot own 80 percent or more of the voting stock and 80 percent or more of the value of the stock of another corporation. I.R.C. §§ 1361(b)(2)(B), 1504(a)(2).

(2) In order to elect S corporation status and to prevent S corporation status from being terminated, a corporation cannot have as a shareholder another corporation. I.R.C. § 1361(b)(1)(B).

b. The Internal Revenue Service has adopted a "momentary control" approach to mergers and acquisitions involving S corporations, allowing the S corporation to have transitory ownership of a controlling interest in the stock of another corporation without terminating the S election. See, for example, Rev. Rul. 73-496, 1973-2 C.B. 312; Ltr. Rul. 8739010. But see Haley Bros.
c. An S corporation that has always been an S corporation, has been an S corporation for at least ten years, or does not have any built-in gains will avoid the double taxation involved in taxable mergers and acquisitions transactions, since there will be only one tax payable at the shareholder level.

C. Corporate Law Considerations: In General.

1. Generally, the board of directors of each corporation involved in a mergers and acquisitions transaction must approve the transaction.

   a. In some cases board approval will be required specifically by statute. Such is the case in a merger or share exchange.

   b. In other cases, approval will be required because the transaction is a significant corporate action. Such may be the case with respect to the buyer's acquisition of assets of the target.

   c. The approval of the board of directors of the target will not be required if the stock of the target is acquired through one or more tender offers.

2. In a mergers and acquisitions transaction, shareholder approval is usually required on the part of the target and in some cases is required on the part of the buyer.

   a. Generally, the vote of more than two-thirds of all votes entitled to be cast in each class of voting stock will be needed for shareholder approval.

      (1) The board of directors may submit the transaction to the shareholders on the condition that the shareholders approve the transaction by a greater vote.

      (2) The articles of incorporation may provide that a greater or lesser shareholder vote is required for approval of the transaction, so long as such such vote is at least a majority of all
votes actually cast in each class of voting stock.

b. Approval by the buyer's shareholders is not required in a share exchange or acquisition of assets.

c. While the buyer's shareholders are usually required to approve a merger, this requirement is eliminated in a merger involving a 20 percent or less increase in the outstanding stock of the buyer if certain conditions are met.

3. If shareholder approval of a mergers and acquisitions transaction is required, the shareholders who oppose the transaction will have a right to receive payment for the fair value of their shares (dissenters' rights).

4. Under an amendment to the Virginia Stock Corporation Act that became effective on July 1, 1990, all of these requirements can arguably be eliminated or modified in a corporation with 35 or fewer shareholders by means of a qualified shareholder agreement. Va. Code § 13.1-671.1. However, the Virginia courts have yet to interpret this new provision.

II. MERGERS

A. Nontaxable Mergers (A Reorganizations): Requirements.

1. Regular merger.

   a. A regular merger must be a merger that meets the statutory requirements of Virginia law (or the law of another state, the United States, or the District of Columbia). Reg. § 1.368-2(b)(1).

2. Forward triangular merger.

   a. In a forward triangular merger, the buyer creates a subsidiary and contributes a portion of its stock to the subsidiary in exchange for the subsidiary's stock. The target is then merged into the subsidiary. In exchange, the subsidiary transfers stock of the buyer which it holds to the target's shareholders.
b. To qualify as an A reorganization, the subsidiary must acquire substantially all the properties of the target partly or entirely in exchange for stock of the buyer.

(1) The transaction must have a business purpose, and there must be continuity of interest.

(2) No stock of the subsidiary may be used in the transaction.

c. Although no stock of the subsidiary can be used in the transaction, other property, such as cash and securities, of the subsidiary or buyer can be used, as long as the continuity of interest requirement is satisfied.

d. The buyer may also assume liabilities of the target without disqualifying the transaction.

e. For advance ruling purposes, the requirement that the subsidiary receive substantially all the assets of the target is satisfied if 90 percent of the fair market value of the target's net assets and 70 percent of its gross assets are transferred to the subsidiary.

Reg. § 1.368-2(b)(2).

3. Reverse triangular merger.

a. In a reverse triangular merger, the buyer creates a subsidiary and contributes a portion of its stock to the subsidiary in exchange for the subsidiary's stock. The subsidiary is then merged into the target, which receives the buyer's stock held by the subsidiary. In exchange, the target's shareholders transfer stock in the target to the buyer in exchange for voting stock of the buyer.

b. The target must not only own all its own assets after the transaction is completed but also substantially all the assets of the subsidiary.

c. At least 80 percent of the voting power and 80 percent of the outstanding nonvoting stock
of the target must be exchanged for voting stock of the buyer (the remaining 20 percent of the consideration can be other forms of payment).

I.R.C. § 368(a)(2)(E) and Reg. § 1.368-2(j).

B. Taxable Mergers.

1. A merger under state law will be taxable if all the consideration passing to the shareholders of the target is boot (cash and property) or the transaction fails to be nontaxable because of one or more of the three nonstatutory doctrines (continuity of interest, business purpose, step transaction).

2. In a forward or reverse triangular merger, the transaction will be taxable if the additional requirements imposed on these forms of A reorganizations are not satisfied.

C. Tax Consequences to the Parties.

1. Nontaxable mergers.

a. The buyer will not recognize any taxable loss and will only recognize taxable gain to the extent that it uses appreciated property to acquire the stock or assets of the target, since a corporation does not recognize taxable gain or loss on the issuance of its own stock.

(1) The assets acquired by the buyer will have a carryover basis, increased to the extent of any taxable gain recognized to the target's shareholders.

(2) In the case of a triangular merger, it is possible to make an election under I.R.C. § 338 to step up the basis of the assets, but this also involves recognition of taxable gain to the subsidiary in the case of a forward triangular merger and to the target in the case of a reverse triangular merger.

b. The shareholders of the buyer generally do not have any current tax consequences.
The shareholders of an S corporation may recognize taxable gain or loss if the buyer uses property other than its own stock or securities to acquire stock or assets.

c. The target will have no tax consequences unless in a triangular merger an I.R.C. § 338 election is made.

d. The shareholders of the target will recognize taxable gain only to the extent that they receive boot, except for shareholders who receive no stock of the buyer, who will recognize gain or loss equal to the difference between their basis in the stock of the target and the fair market value of the assets received.

2. Taxable mergers.

a. The buyer will not recognize taxable loss and will recognize taxable gain only to the extent that it uses appreciated property to acquire stock or assets of the target.

b. The shareholders of the buyer generally do not have any current tax consequences.

(1) The shareholders of an S corporation may recognize taxable gain or loss if the buyer uses property other than its own stock or securities to acquire stock or assets.

c. The target will not have any taxable gain or loss in a straight merger but may recognize taxable gain or loss in a triangular merger if the target is liquidated.

d. Each shareholder of the target corporation will recognize taxable gain or loss equal to the difference between the shareholder's basis in the shares of the target given up and the fair market value of the assets received (including stock of the buyer).

D. Corporate Law Considerations for a Merger.

1. One or more corporations may merge into another corporation if the articles of incorporation of each of them could lawfully contain all the

2. The board of directors of each corporation must adopt a plan of merger. Id.

3. In most circumstances, the shareholders of each corporation must approve the plan of merger. Va. Code § 13.1-718.A.

a. However, the shareholders of the buyer are not required to approve the plan of merger if:

   (1) The articles of incorporation of the buyer after the merger will not differ substantially from the articles before the merger;

   (2) The number and types of shares held by each shareholder of the buyer immediately before the merger will be identical to those held by that shareholder immediately after the merger; and

   (3) The number of voting and participating shares outstanding immediately after the merger will not exceed by more than 20 percent the number of voting and participating shares outstanding immediately before the merger.

   (a) Participating shares are common stock and any other types of stock entitled to participate fully in distributions.


b. In most cases, each class of voting stock of each corporation must approve the plan of merger by more than two-thirds of the votes entitled to be cast with respect to such class.

   (1) The board of directors may condition its submission of the plan to the shareholders on a greater vote.

   (2) The articles of incorporation may provide that a greater or lesser vote is
required for approval, provided that such vote is at least a majority of all votes actually cast in each such class of stock.


4. The plan of merger must contain the following:

a. The name of each corporation planning to merge and the name of the surviving corporation into which each other corporation plans to merge;

b. The terms and conditions of the merger; and

c. The manner and basis of converting:

(1) The shares of each corporation that is a party to the merger into shares, obligations, or other securities of the surviving or any other corporation, or into cash or other property; and

(2) The rights to acquire shares of each corporation that is a party to the merger into rights to acquire shares, obligations, or other securities of the surviving corporation, or into cash or other property.


5. The plan of merger may also set forth:

a. Amendments to, or a restatement of, the articles of incorporation of the surviving corporation; and

b. Any other provisions relating to the merger.


6. Articles of merger must be filed with the State Corporation Commission after a plan of merger has been properly approved. Va. Code § 13.1-720.A.

a. The articles of merger must include a copy of the plan of merger and either a statement that shareholder action on the plan was not required or a description of the shareholder action taken. Id.
b. If the articles of merger have been properly filed and all fees have been paid, the State Corporation Commission will issue a certificate of merger. Va. Code § 13.1-720.B.

c. The Virginia Code does not expressly state when a merger becomes effective. However, Virginia Code §§ 13.1-718.1 and J, which address amendments and abandonments of plans of merger, imply that a merger is not effective until the State Corporation Commission issues a certificate of merger.

7. If a parent corporation owns at least 90 percent of the outstanding shares of each class of stock of a subsidiary corporation, the subsidiary may be merged into the parent without the approval of the shareholders of either corporation or the board of directors of the subsidiary. Va. Code § 13.1-719.A.

a. The only requirements are approval by the parent's board of directors and the mailing of a copy of the plan of merger to each shareholder of the subsidiary. Va. Code §§ 13.1-719.B, C.

b. Alternatively, the parent may merge itself into the subsidiary without approval of the subsidiary's shareholders. However, in this instance, the parent's shareholders must approve the plan of merger. Va. Code § 13.1-719.A.


d. The subsidiary's shareholders, and, if the parent is merged into the subsidiary, the parent's shareholders, will have dissenters' rights, as discussed in the next item. Va. Code § 13.1-730.1.


a. Except in circumstances involving publicly or widely held corporations, a shareholder who is entitled to vote on a plan of merger (or a shareholder of the subsidiary in a parent-
subsidiary merger) is entitled to dissent from the merger and redeem all of his or her shares for their fair value. Va. Code § 31.1-730.1.

b. If a shareholders' meeting is called to approve a plan of merger, the meeting notice must state that shareholders are entitled to exercise dissenters' rights with respect to the merger. Va. Code § 13.1-732.A.

c. A shareholder intending to exercise dissenters' rights with respect to a proposed merger must give written notice to the corporation prior to the shareholder vote and must not vote in favor of the plan of merger. Va. Code § 13.1-733.A.

d. The corporation must then provide dissenting shareholders with a form directing where to demand payment and return stock certificates. Va. Code § 13.1-734.

e. The dissenting shareholder must demand payment and return his or her stock certificates within the prescribed time period in order for his or her shares to be redeemed. Va. Code § 13.1-735.

f. A corporation must redeem the shares of each shareholder who has returned his or her payment demand and stock certificates for the corporation's estimate of the fair value of his or her shares, plus accrued interest.

(1) If the dissenter disagrees with the estimate, he or she must notify the corporation of his or her estimate.

(2) If the amount of payment is not resolved between the corporation and the dissenting shareholder, the corporation is required to bring an action in circuit court to resolve the matter.


E. Practical Considerations.

1. A regular merger is generally easy to accomplish if shareholders owning more than two-thirds of
each class of voting stock of each corporation are willing to agree to the proposed merger.

2. In a forward triangular merger, the following objectives are achieved:

a. The shareholders of the buyer do not have to approve the transaction. A forward triangular merger is often used where the buyer is a public corporation in order to avoid the expenses and time delays associated with obtaining shareholder approval.

   (1) However, a forward triangular merger can also be advantageous in the context of a small corporation.

      (a) For example, a forward triangular merger can be used to avoid triggering dissenters' rights.

      (b) In addition, a forward triangular merger can be used if a shareholder group controls the board of directors of the buyer but does not have sufficient stock ownership to approve a direct merger. The board can create a new subsidiary without shareholder approval and direct the subsidiary to merge with the target.

b. The buyer does not become subject to the liabilities of the target unless the subsidiary's corporate veil is pierced.

c. Leases and other contractual arrangements do not have to be transferred to the buyer.

3. In a reverse triangular merger, the following objectives are achieved:

a. The shareholders of the buyer do not have to approve the transaction.

   (1) Elimination of this requirement presents the same advantages as with a forward triangular merger.

b. The buyer does not become subject to the liabilities of the target unless the target's corporate veil is pierced.
c. Leases and other contractual arrangements do not have to be transferred to the buyer.

d. Nontransferable contractual rights of the target may be retained.

III. STOCK EXCHANGES

A. Nontaxable Share Exchanges (B Reorganizations): Requirements.

1. A stock for stock reorganization under § 368(a)(1)(B) must satisfy the following requirements:

   a. The buyer (or its subsidiary in a forward triangular exchange) must have control of the target immediately after the acquisition. Reg. § 1.368-2(c).

      (1) Control is defined as 80 percent or more of the voting stock and 80 percent or more of all classes of stock of the target. I.R.C. § 368(c).

      (2) Pre-existing ownership will not prevent an exchange of stock from satisfying this "control" requirement if the prior transaction was unrelated. Reg. § 1.368-2(c).

   b. The buyer (or its subsidiary in a forward triangular exchange) must acquire the target's stock "solely for voting stock" of the buyer (or the buyer's subsidiary). Reg. § 1.368-2(c).

      (1) A combination of the buyer's stock and stock of the buyer's subsidiary will not satisfy this "solely for voting stock" requirement. Reg. § 1.368-2(c).

      (2) A combination of the buyer's stock and an affiliate's cash in one transaction will not satisfy the "solely for voting stock" requirement. Rev. Rul. 85-139, 1985-2 C.B. 123.

      (3) A separate transaction between the buyer and a shareholder of the target by which
the shareholder will be paid consideration other than voting stock will not prevent tax-free treatment unless the transaction constitutes an indirect payment for the target's securities. Examples of separate transactions are cash payments for a covenant not to compete of the shareholder or a patent, trademark or copyright owned by the shareholder.

B. Taxable Share Exchanges.

1. Cash or property is exchanged for shares of the target.
   a. The buyer may use some of its voting stock to acquire the stock of the target as long as cash, property or nonvoting securities are also used.

C. Tax consequences to the Parties.

1. Nontaxable share exchanges.
   a. The buyer will not recognize any gain or loss because of the issuance of its own stock. I.R.C. §§ 361(a) and 1032.
   b. The shareholders of the buyer will not recognize any gain or loss.
   c. The target will not recognize any gain or loss.
   d. The shareholders of the target will not recognize any gain or loss.

2. Taxable share exchanges.
   a. The buyer will not recognize any gain or loss on the issuance of its stock, but will recognize gain or loss if it uses property other than its own stock or securities to acquire stock of the target.

(1) Note that if the corporation is an S corporation and it acquires 80 percent or more of the target's stock, it will have to liquidate the target as part of the transaction or the S election will be terminated.
b. The shareholders of the buyer will not recognize any gain or loss unless the buyer is an S corporation and the corporation uses property other than its own stock or securities to acquire stock of the target.

c. The target will not recognize any gain or loss unless it is liquidated, in which case it may recognize gain or loss with respect to property other than cash that is distributed to its shareholders.

d. The shareholders of the target will recognize gain or loss equal to the difference between the basis of their stock in the target and the fair market value of the consideration received from the buyer for their stock.

(1) The shareholders of the target who continue as shareholders of the target will recognize gain or loss if the target is liquidated.

D. Corporate Law Considerations for a Share Exchange.

1. The share exchange provisions of the Virginia Stock Corporation Act allow a buyer to acquire all the outstanding shares of one or more classes of the target's stock by means of corporate action on the part of the target. Va. Code § 13.1-717.A.

a. If the buyer does not acquire 100 percent of any class of stock of the target, the share exchange requirements are not applicable.

b. The buyer could purchase the stock directly from the shareholders of the target, perhaps pursuant to one or more tender offers. In such event, there would be no requirement for shareholder approval by the shareholders of either the buyer or the target. Va. Code § 13.1-717.D.

2. Where the share exchange provisions are applicable, the board of directors of each corporation must adopt a plan of share exchange. Va. Code § 13.1-717.B.

3. Only the shareholders of the target are required to approve the plan of share exchange. Va. Code § 13.1-718.A.
4. As with a plan of merger, more than two-thirds of all votes entitled to be cast in each class of voting stock is generally required for approval of a plan of share exchange.

a. The board of directors may condition its submission of the plan to the shareholders on a greater vote.

b. The articles of incorporation may provide that a greater or lesser vote is required for approval, so long as that vote is at least a majority of the votes actually cast in each class of voting stock.


5. After the plan of share exchange has been properly approved, articles of share exchange must be filed with the State Corporation Commission. Va. Code § 13.1-720.A.

a. The articles must include the plan of share exchange and either a statement that shareholder action was not required or a description of the shareholder action taken. Id.

b. If the articles of share exchange are properly filed and all fees are paid, the State Corporation Commission will issue a certificate of share exchange. As with a merger, a share exchange is not effective until the certificate is issued. Va. Code §§ 13.1-720.B and -718.I and J.


E. Practical Considerations.

1. By acquiring the stock of the target rather than merging the target into the buyer, the buyer is insulated from liabilities of the target as long as the target's corporate veil is not pierced.

2. If the target is not liquidated immediately into the buyer, the buyer's S corporation status will be terminated.
3. If the target is liquidated pursuant to the plan of reorganization, then the reorganization will not qualify as a B reorganization but will be tested under the C reorganization rules.

IV. ASSET ACQUISITIONS

A. Nontaxable Asset Acquisitions (C Reorganizations): Requirements.

1. In a C reorganization, the buyer or a subsidiary of the buyer must transfer its voting stock for all or substantially all the assets of the target. Reg. § 1.368(d)(1).

   a. For ruling purposes, 90 percent of the fair market value of the net assets and 70 percent of the gross assets of the target must be acquired and the target must be liquidated as part of the transaction.

2. The buyer or a buyer's subsidiary must acquire the target's assets "solely for voting stock" of either the buyer or the buyer's subsidiary.

   a. As with a B reorganization, a combination of the buyer's stock and stock of the buyer's subsidiary will not satisfy this "solely for voting stock" requirement. Reg. § 1.368-2(d)(1).

   b. Assumption of target liabilities or acquisition of property subject to liabilities does not affect this "solely for voting stock" requirement. Reg. § 1.368-2(d)(1).

   c. Up to 20 percent of the consideration can be other than voting stock, but if it is, the target's liabilities that are either assumed or otherwise attached to the assets being purchased count as "other consideration" (and all other consideration is taxable boot). Reg. § 1.368(d)(2).

B. Taxable Asset Acquisitions.

1. The buyer uses cash, its own stock and securities, and other property to acquire the assets of the target, but does not satisfy the requirements for a C reorganization.
C. **Tax consequences to the Parties.**

1. **Nontaxable asset acquisitions.**
   
a. The buyer does not recognize any gain or loss on the issuance of its stock.

   (1) If the buyer uses other property to acquire some of the assets, it will recognize gain or loss.

b. The shareholders of the buyer should recognize no gain or loss unless the buyer is an S corporation and uses property other than its own stock or securities to purchase some of the assets.

c. The target corporation will recognize gain (and perhaps loss) upon the distribution of any boot received upon its liquidation.

   (1) The target must be liquidated in order to qualify the transaction as a C reorganization.

d. The shareholders of the target will not recognize any gain or loss except to the extent that boot is distributed.

2. **Taxable asset acquisitions.**

a. The buyer will not recognize any gain or loss upon the issuance of its shares or the use of cash to purchase the assets of the target, but will recognize gain and loss to the extent it uses other property.

b. The shareholders of the buyer will not recognize any gain or loss unless the buyer is an S corporation and uses other property to acquire the assets of the target.

c. The target will recognize gain or loss as a result of the sale of its assets to the buyer.

   (1) The target will also recognize gain or loss upon its liquidation, if the target is indeed liquidated.

d. The shareholders of the target will not recognize any gain unless either:
The target is an S corporation and any gain or loss on the sale of the target's assets is passed through to the shareholders; or

The target is liquidated and the shareholders recognize gain or loss as a result of the liquidation.

D. Corporate Law Requirements for Asset Acquisitions.

1. Shareholder approval is generally not required for a transaction involving the sale, lease, exchange or other disposition of all or substantially all of a corporation's property, if the transaction is in the usual and regular course of business. Va. Code § 13.1-723.B.
   a. The articles of incorporation may require shareholder approval of this type of transaction. Id.
   b. Whether a transaction is in the usual and regular course of business depends on the specific facts concerning the transaction.
   c. Approval by the board of directors is required because the transaction is a significant one.

2. If a transaction involves the disposition of all or substantially all of a corporation's assets other than in the usual and regular course of business, shareholder approval is required. Va. Code § 13.1-724.A.

(1) If the board of directors determines that it should make no recommendation because of a conflict of interest or other special circumstances, it must submit the basis for its determination to the shareholders, along with the proposed transaction. Id.

b. The shareholders must approve the action by more than two-thirds of all votes entitled to be cast with respect to the transaction.
(1) It is unclear whether the voting requirement applies to each class of stock (as with a merger or share exchange) or to voting stock in the aggregate.

(2) The board of directors may condition its submission of the proposed transaction on a greater vote.

(3) The articles of incorporation may provide that a greater or lesser vote is required for approval, so long as such vote is not less than a majority of all votes actually cast by each class of voting stock.


3. The target's shareholders are entitled to exercise dissenters' rights in the same manner as in a merger transaction, unless the sale is for cash pursuant to a plan by which substantially all of the net proceeds of the sale will be distributed to the target's shareholders within one year from the sale. Va. Code § 13.1-730.A.3.

E. Practical Considerations.

1. The buyer will not be subject to the liabilities of the target unless the asset acquisition is treated as a merger under the de facto merger doctrine.

2. In a taxable asset acquisition, the shareholders of a C corporation target will generally incur double taxation, once at the corporate level and once at the shareholder level, unless the target is continued in existence, perhaps as a personal holding company.
THIS ASSET PURCHASE AGREEMENT, made as of the ___ day of ____________, 19__, between ________________________, a Virginia corporation (the "Seller"), ________________________, (the "Shareholder") and ________________________, a Virginia corporation (the "Purchaser").

RECITALS:

1. The Seller operates a ________________________ (the "Business") and desires to sell substantially all the Assets, as hereinafter defined, of the Business.

2. The Seller also owns a parcel of land containing approximately ________ square feet and a building located at ____________, ________, ________, as more particularly described on Schedule 1 (the "Property").

3. The Purchaser desires to purchase the Assets and the Property of the Seller to enable the Purchaser to operate the Business as a going concern.

AGREEMENT:

NOW, THEREFORE, in consideration of the foregoing and the mutual promises, covenants and conditions hereinafter contained, the receipt and sufficiency of which are acknowledged by the parties hereto, the parties agree as follows:

1. Property and Assets Conveyed. Seller agrees to transfer, assign, convey and sell to Purchaser and Purchaser agrees to purchase, on ____________, 19__ (the "Closing Date"), free from all liabilities, liens and encumbrances of any type, the following assets (the "Assets"): 
(a) all inventory as shown on Schedule 2;
(b) all other tangible personal property, which consists of equipment, furniture, tools and other supplies shown on Schedule 3, but specifically excludes the personal items shown on Schedule 4;
(c) the contracts shown on Schedule 5;
(d) customer lists; and
(e) good will.

2. Assets Not Conveyed. The Assets conveyed in this sale do not include the accounts receivable of the Seller and cash on hand as of the Closing Date.

3. Purchase Price. The purchase price for the sale of the Assets is $________. The purchase price for the sale of the Property is $________. The combined total shall be hereinafter referred to as the "Purchase Price".

4. Allocation of Purchase Price. The purchase price will be allocated as follows:

**Tangible Assets**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory</td>
<td>______</td>
</tr>
<tr>
<td>Personal Property</td>
<td>______</td>
</tr>
<tr>
<td>Contracts</td>
<td>______</td>
</tr>
<tr>
<td>Customer Lists</td>
<td>______</td>
</tr>
<tr>
<td>[Accounts Receivable]</td>
<td>[______]</td>
</tr>
</tbody>
</table>

Total Tangible Assets $ ______

**Intangible Assets**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill</td>
<td>______</td>
</tr>
</tbody>
</table>

Total Intangibles $______
Total Cost of Assets $_____
Property $_____

5. **Payment Method.** The purchase price for the Assets shall be paid by the delivery of cash or a cashier's check in the amount of $______ and a promissory note (the "Asset Note") payable as shown in the form of Exhibit A. The Purchase Price for the Property shall be paid by delivery of cash or a cashier's check in the amount of $______ and a promissory note (the "Property Note") payable as shown in the form of Exhibit B. The Asset Note and the Property Note are hereinafter referred to collectively, as the "Notes".

6. **Collateral Security for the Seller.** As collateral security for the Purchaser's obligations pursuant to this Agreement, the Purchaser shall grant a deed of trust (the "Deed of Trust") on the Property in the form of Exhibit C and a continuing security interest in the Assets [pursuant to a security agreement (the "Security Agreement") in the form of Exhibit D].

7. **Seller's and the Shareholder's Representations and Warranties.** Seller and the Shareholder, jointly and severally, represent and warrant to Purchaser, with the knowledge that Purchaser is purchasing Seller's Assets and the Property in full reliance thereon, the following:

   (a) **Due Organization.** Seller is a corporation duly organized, validly existing and in good standing under the laws of the Commonwealth of Virginia, with full power and authority to
own its properties and to carry on the business presently conducted by it.

(b) **Due Authorization.** The Seller has the requisite power and authority to enter into this Agreement and to carry out its obligations hereunder. The execution and delivery to Purchaser of this Agreement and the transactions contemplated hereby (i) have been duly authorized by Seller's board of directors and (ii) do not violate or cause a default under any license, permit, authorization, grant, contract, note, deed of trust, agreement, lease, covenant or other document, order or regulation to which Seller is a party or bound. This Agreement, when executed by Seller and Purchaser, shall constitute a legal, valid and binding obligation of Seller and shall be enforceable by Purchaser in accordance with its terms.

(c) **Stock Ownership.** The Shareholder is the owner of all the issued and outstanding shares of capital stock of the Seller.

(d) **Financial Statements.** Seller has delivered to Purchaser true and complete copies of its [audited] financial statements (including, but not limited to, a balance sheet, an income statement and a statement of sources and applications of funds) for fiscal years 19_____ and 19____ and [its unaudited financial statements] for the fiscal quarter ended _____, 19____ (collectively, the "Financial Statements"). Such Financial Statements have been prepared in accordance with generally accepted accounting principles, consistently applied, accurately
set forth the results of operations of the Seller for the respective periods indicated, and present true and complete statements of the financial condition, assets and liabilities (whether accrued, absolute, contingent or otherwise) of the Seller as at the end of such respective periods.

(e) Absence of Liabilities. Except as and to the extent reflected or reserved against in the Financial Statements, Seller, as of the dates of such Financial Statements, had no other liabilities or obligations of any nature, whether absolute, accrued, contingent or otherwise and whether due or to become due. Seller neither knows nor has any reasonable ground to know of any basis for an assertion against Seller as of the date of this Agreement, of any liability of any nature or in any amount not fully reflected or reserved against in the Financial Statements.

(f) Litigation. Except as shown on Schedule 6, there is no known litigation, proceeding or investigation pending, or threatened, which (i) might result in any materially adverse change in the Business or the prospects thereof, or in Seller's financial condition or in any of its Assets or the Property, or (ii) questions the validity of any action taken or to be taken by Seller pursuant to or in connection with any provision of this Agreement. Seller does not know or have any reasonable ground to know of any basis for any such litigation, proceeding or investigation.
(g) **Title.** Seller has good, marketable and indefeasible title to all and any part of the Assets and the Property, which title is as of the date of this Agreement or at the settlement hereunder on the Closing Date will be free and clear of all mortgages, conditional sales agreements, leases, liens, hypothecations, pledges, encumbrances, charges or claims. The Assets and the Property shall be conveyed free and clear of any rental, management, service, maintenance, employment or other contracts, whether oral or written, and Purchaser shall have no liability whatsoever in connection therewith.

(h) **Condition of Assets.** The Assets are (as to physical plant and structure) structurally sound and none of the Assets has any material defects and all of them are in all material respects in good operating condition and repair and are adequate for the uses to which they are being put; none of the Assets, including vehicles or other equipment, is in need of maintenance or repairs except for ordinary, routine maintenance and repairs which are not material in nature or cost.

(i) **Inventories.** All Inventories of the Seller, whether or not reflected in the Financial Statements, are of a quality and quantity usable and saleable in the ordinary course of business, except for obsolete items and items of below-standard quality, all of which, in the aggregate, are immaterial in amount. Items included in such Inventories are carried on the books of the Seller, and are valued on the Financial Statements, at the lower of cost or market and, in any event, at not greater
than their net realizable value, on an item by item basis, after appropriate deduction for costs of completion, marketing costs, transportation expense and allocation of overhead.

(j) Hazardous Waste; Title Insurance. The Property is free of any and all hazardous wastes, hazardous emissions, toxic substances or other types of contamination or matters of environmental concern, and the Seller is not subject to any liability (under the Comprehensive Environmental Response, Compensation and Liability Act or otherwise) resulting from or related to any such wastes, emissions, substances, contaminants or matters of environmental concern in connection with the Property. [The Seller has, in connection with acquiring ownership of the Property, (i) caused an audit and examination to be made as to the existence of any hazardous wastes, hazardous emissions, toxic substances or other types of contamination or matters of environmental concern affecting each such parcel constituting the Property, which examination indicates that such Property was free of any the wastes, emissions, substances, contaminants or other matters of environmental concern, and the Seller has delivered a copy of the report of such audit and examination to the Purchaser and (ii) obtained an appropriate policy of title insurance insuring the interest of the Seller in the Property, which insurance policy was not subject to any exceptions not reasonably acceptable in the ordinary course of business, a copy of which has been delivered to the Purchaser.]
(k) **Leases.** [There are no leases with respect to the Property or any of the Assets.] [The Seller shall assign to the Purchaser each of the leases shown on Schedule 7. Copies of such leases together with any consents required as a condition to their assignment have been delivered to the Purchaser.]

(l) **Condemnation.** Neither Seller nor the Shareholder has received any notice nor does Seller or the Shareholder have any knowledge that all or any part of the Property is or will be acquired or threatened to be acquired by authority of any governmental body, agency or department in the exercise of its power of eminent domain or by private purchase in lieu thereof.

(m) **Permits.** Seller has all consents, approvals, licenses and permits of any level of government or any boards, agencies, departments and officials that are necessary for the lawful conduct of the Business at its present location on the Property. There are no judgments or injunctions, pending or threatened, that relate to, limit or affect the Business or the Property. Seller has not received any notice and Seller does not have any knowledge that any consent, approval, license or permit issued to Seller in connection with the Business or the Property on which it is conducted has been cancelled, withdrawn or modified or any such action is contemplated or threatened by any person, entity, governmental body, or board, agency, department or official thereof.

(n) **Trade Name.** After the Closing Date, Seller shall not use the trade name ________________, or any confusingly
similar name, for any purpose whatsoever. On the Closing Date, Seller shall convey to Purchaser the right to use the current telephone numbers of the Business.

(o) **Bulk Sales.** Seller has no existing creditors to whom notice is required under Article 6 of the Virginia Uniform Commercial Code.

(p) **Labor Matters.** There are no activities or controversies, including, without limitation, any labor organizing activities, election petitions or proceedings, proceedings preparatory thereto, unfair labor practice complaints, labor strikes, disputes, slow-downs or work stoppages, pending or, to the best of the knowledge of the Seller and the Shareholder, threatened, between the Seller and any of its employees.

(q) **ERISA.** With respect to each employee pension, profit sharing, welfare benefit, or other plan to which the Seller is required to contribute or has in the past six years contributed on behalf of employees of the Seller, and the plans which the Seller has maintained or now maintains, there are no pending or threatened claims, fines, penalties, disqualifications, lawsuits or arbitrations which have been asserted or instituted against the plans, any fiduciaries thereof respecting their duties to the plans or the assets of any of the trusts under any of the plans.

The Seller represents that all [retirement] plans will be either frozen or terminated, at the direction of the
Purchaser, contemporaneously with the Closing. If such plans are
terminated, termination procedures and any asset distributions
shall take place as soon as administratively feasible; but, in
any event, within 30 days of the date of issuance by the Internal
Revenue Service of a favorable determination letter with respect
to qualification of the plans on termination.

(r) **Accounts Receivable.** All accounts receivable of
the Seller, whether or not reflected in the Financial Statements,
represent transactions in the ordinary course of business, and
are current and collectible net of any reserves shown on such
Financial Statements (which reserves are adequate and were
calculated consistent with past practice). Schedule 8
specifically identifies (a) the aging of Receivables, (b) each
Receivable in excess of $______, (c) each Receivable in an
amount in excess of $______ that is more than 90 days past due,
and (d) each Receivable from a person or entity from whom the
aggregate of such Receivables exceeds $______

(s) **No Misstatements or Omissions.** No representation
or warranty by Seller or the Shareholder contained in this
Agreement and no statement furnished or to be furnished to
Purchaser pursuant hereto or in connection with the transactions
contemplated hereby, contains or will contain at Closing any
untrue statement of material fact, or omits or will omit at
Closing to state a material fact necessary in order to make the
statements contained therein not misleading or necessary in order
to provide Purchaser with proper and accurate information as to the Business, the Property or the Assets.

8. **Assignment of Licenses and Permits.** In addition to the Assets and the Property, Seller agrees that, on the Closing Date, Seller will assign, transfer and set over to Purchaser, with prorata adjustment of the cost or expense therefor all Seller's consents, approvals, licenses and permits that are necessary for the lawful conduct of the Business and which are assignable by law.

9. **Operation of Practice and No Assumption of Liabilities.** Subject to Section 11, Seller shall have the right to operate the Business until the Closing Date and the profits therefrom and expenses thereof incurred through such date shall belong to and be the responsibility of Seller. Seller and Purchaser agree that Purchaser is not assuming and will not be liable in any way for any liabilities or obligations of Seller or the Business incurred when owned by Seller. All expenses incurred and profits derived from the Business after the Closing Date shall belong to and be the responsibility of Purchaser.

10. **Affirmative Covenants of Seller and Shareholder.** During the period from the date of this Agreement to the Closing Date, Seller and the Shareholder shall:

    (a) Conduct the Business in the same manner that it has heretofore been conducted, including but not limited to paying all of its debts and performing all of its obligations in the normal course of business;

    - 11 -
(b) Maintain and preserve the Business and Seller's relationships with its customers and all other persons or entities;

(c) Maintain the Property and the Assets so that the Property and the Assets are in a condition no worse than their present condition; and

(d) Maintain Seller's books of account in a manner that fairly and correctly reflects its assets, income, expenses and liabilities.

11. **Negative Covenants of Seller and Shareholder.** During the period from the date of this Agreement to the Closing Date, Seller and the Shareholder shall not, unless the Purchaser shall have given its consent in writing thereto:

   (a) Cancel, modify, assign or in any way terminate or encumber any obligation, agreement, arrangement, commitment or undertaking, except in the usual and ordinary course of Seller's business;

   (b) Sell or dispose of, or agree to sell or dispose of, any of the Assets or the Property or suffer or permit the creation of any mortgage, pledge, lien, lease or other encumbrance, security interest or imperfection of title thereon or with respect thereto, except in the usual and ordinary course of business;

   (c) Enter into any transaction or agreement, or extend or renew any existing agreement, not in the usual and ordinary
course of business which affects the operations, business or prospects of Seller; or

(d) Make any distributions of any of the Assets or the Property to the Shareholder.

12. Conditions to Obligations of Purchaser. The obligations of Purchaser to complete the transactions provided for herein shall be subject, at its election, to the following conditions:

(a) This Agreement shall have been duly authorized, executed and delivered by Seller and Shareholder;

(b) Seller and Shareholder shall have performed all agreements required to be performed hereunder by any of them on or before the Closing Date;

(c) From the date of this Agreement to the Closing Date, there has not been (i) any change in Seller's financial condition, assets, liabilities, or business, other than changes in the usual and ordinary course of business, or (ii) any damage, destruction or loss, whether or not covered by insurance, from any cause whatsoever including but not limited to fire, accident or act of God adversely affecting the Property, the Assets or the Business, or any part thereof;

(d) Seller and the Shareholder shall have delivered to Purchaser on the Closing Date certificates executed respectively by the President of Seller and the Shareholder, dated the date of delivery, to the effect that (i) as of the Closing Date, each of the representations and warranties
contained in this Agreement are true and correct in all material respects and (ii) between the date hereof and the Closing Date, Seller has and the Shareholder have complied in all material respects with the provisions of this Agreement; and

(e) Purchaser being satisfied that as of the Closing Date all necessary approvals, licenses and permits for the Business may be transferred by Seller to Purchaser or may be obtained by Purchaser upon application therefor without payment of any fees other than normal application fees.

13. **Conditions to Obligations of Seller.** The obligations of Seller to complete the transactions provided for herein shall be subject to the conditions that this Agreement, the Notes, the Deed of Trust and the Security Agreement shall have been duly authorized, executed and delivered by Purchaser.

14. **Prorations.** The following items shall be apportioned and prorated as of the Closing Date, and the Purchase Price adjusted accordingly:

(a) Personal property taxes related to any of the Assets;

(b) Real estate taxes, utility and insurance charges related to the Assets or the Property; and

(c) Other proratable items.

15. **Indemnification.** Seller and the Shareholder, jointly and severally, agree to and do hereby indemnify and hold harmless Purchaser, with respect to any claims, losses, obligations, liabilities, costs and expenses, including
attorneys' fees, incurred or accrued by reason of (a) any misrepresentations by any of Seller or the Shareholder or (b) any breach of any warranty, covenant, term or condition by Seller or the Shareholder contained in this Agreement or any instrument executed pursuant to this Agreement. If any action, suit or proceeding is brought against the Purchaser for damages for which the Seller is required to provide indemnification under this section, the Seller, upon request, shall at its own expense resist and defend such action, suit or proceeding, or cause the same to be resisted and defended by counsel designated by the Seller and approved by the Purchaser, which approval shall not be unreasonably withheld, provided that such approval shall not be required in the case of defense by counsel designated by any insurance company undertaking such defense pursuant to any applicable policy of insurance. The Purchaser shall have the right to employ separate counsel in any such action, suit or proceeding and to participate in the defense thereof, but the fees and expenses of such counsel will be at the expense of the Purchaser unless the employment of such counsel has been specifically authorized by Seller. The Seller shall not be liable for any settlement of any such action, suit or proceeding made without its consent, but if settled with the consent of the Seller, or if there be a final judgment for the plaintiff in any such action, the Seller shall indemnify and hold harmless the Purchaser from and against any damages and costs, including
reasonable attorney fees, by reason of such settlement or judgment.

16. **Survival of Representations and Warranties.** All the respective representations, warranties, covenants, agreements and indemnifications of each party contained herein shall survive the Closing Date.

17. **Closing.** The closing shall take place at the offices of the __________'s Counsel at __________, __________, __________, on the Closing Date.

On the Closing Date, Seller shall deliver or cause to be delivered to Purchaser the following:

(a) Such good and sufficient General Warranty Deed, with respect to the Property, and General Warranty Bill of Sale, with respect to the Assets, both in form and substance satisfactory to Purchaser and its counsel, to vest good, marketable and indefeasible title in the Property and to each of the Assets in Purchaser, free and clear of all liens, encumbrances, defects and objections.

(b) Such good and sufficient assignments, in form and substance satisfactory to Purchaser and its counsel, of all Seller's right, title and interest in and to the use of (i) the contracts shown on Schedule 5, (ii) governmental approvals of and permits for the Property and the Business, to the extent assignable by law, (iii) warranty rights in connection with the
Assets[, ] [and] (iv) the telephone numbers for the Business [and (v) the leases shown on Schedule 7].

(c) All deeds, leases, contracts, agreements, correspondence and documents of every character to which Seller is a party and all amendments and modifications thereof and all endorsements of title pursuant to which Seller acquired any right, title and interest in and to each of the Assets or the Property.

(d) All books of account, records, files, documents, brochures, literature and papers relating to the Business (other than Seller's minute book, stock book, stock ledger and other books related solely to the capital stock).

(e) The Certificates of the Seller and the Shareholder described in Section 12(d).

(f) An opinion of counsel for the Seller, in the form of Exhibit E and otherwise acceptable to the Purchaser.

(g) Such other documents and statements as may reasonably be requested by Purchaser or its counsel.

18. Termination. This Agreement may be terminated or cancelled, with the attendant release of all liabilities or obligations hereunder between the parties, by either party upon written notice to the other party, if (a) any of the representations and warranties of either party contained herein shall prove to be inaccurate in any material respect, (b) any material obligation to be performed by either party hereunder has not been performed during the period or at or prior to the time
specified herein for such performance, or (c) any condition to the obligation of either party to complete the transaction provided for herein shall not have been satisfied or complied with by the Closing Date; [provided that if the termination is caused due to the inability of Seller to confirm any of the representations and warranties in this Agreement, including the Schedules, then Seller shall compensate Purchaser in the amount of $__________].

19. Expenses. Seller and Purchaser shall pay their own respective expenses and costs, including, without limitation, their separate counsel fees in connection with this Agreement and the transactions contemplated hereby.

20. Additional Documents. Seller and the Shareholder, at any time and from time to time after the Closing Date, upon request of Purchaser, will do, execute, acknowledge, and deliver all such further acts, deeds, assignments, transfers, conveyances, powers of attorney, and assurances as may be required to convey, transfer to, and vest in Purchaser and protect the right, title, interest in, and enjoyment of, the Property and the Assets sold, assigned, transferred or conveyed pursuant to this Agreement.

21. Broker's Commission. Neither Seller nor the Shareholder has retained any broker and therefore no commission has been earned as a result of this transaction, and Seller and Purchaser agree to hold the other harmless from any loss or liability to any broker.
22. **Miscellaneous.**

(a) The terms of this Agreement shall be binding upon
and inure to the benefit of the heirs, successors and assigns of
the parties hereto.

(b) This Agreement contains all the terms, provisions
and agreements between the parties hereto concerning the purchase
to be made herein, and any oral additions or understandings at
variance with or in addition hereto are void and of no effect.

(c) Any agreement hereafter made between the parties
to this Agreement shall be ineffective in changing, modifying, or
discharging this Agreement in whole or in part unless the
agreement is in writing and signed by the party against whom
enforcement of the change, modification, or discharge is sought.
An oral agreement for the modification of this Agreement in any
manner shall be void and of no effect.

(d) This Agreement shall be governed by and construed
in accordance with the laws of the Commonwealth of Virginia.

IN WITNESS WHEREOF, the parties have executed this Agreement
as of the date first mentioned above.

SELLER:

__________________________________________________

By: ____________________________________________

________________________, President
SHAREHOLDER:


PURCHASER:

By:_______________________, President
EXHIBITS

Exhibit A - Form of Asset Note
Exhibit B - Form of Property Note
Exhibit C - Form of Deed of Trust
Exhibit D - Form of Security Agreement
Exhibit E - Form of Opinion of Seller's Counsel
SCHEDULES

Schedule 1 - Property Description
Schedule 2 - Inventory
Schedule 3 - Tangible Personal Property
Schedule 4 - Personal Items Excluded from Tangible Personal Property
Schedule 5 - Contracts
Schedule 6 - Pending Litigation
Schedule 7 - Leases
Schedule 8 - Accounts Receivable
DIAGRAMS OF ACQUISITIVE TAX-FREE REORGANIZATIONS

1. Statutory Merger

2. Statutory Consideration

3. Forward Triangular Merger

4. Reverse Triangular Merger
5. B Reorganization

6. B Reorganization - Parent's Stock Used

7. B Reorganization - Constructive

8. C Reorganization

9. C Reorganization - Parent's Stock Used