Using Royalties In Acquisitions ©

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Royalties--an agreed percentage of revenues for an agreed period--can be used as the basis for a royalty / equity exchange or swap.

The buyer, using royalties based on the revenues of the property to be acquired, gets ownership of the property and the seller sheds the responsibility of management and ownership in return for the benefit of the expansion of the business as required in the swap agreement.

The acquirer agrees to invest a given amount in the company and not to withdraw any funds until revenues reach an agreed level. The seller, accepting the royalty for their stock in the company, gets a fully negotiable agreement requiring the investment of expansion funds and whatever other protections are deemed necessary.

The royalty, which can be sold without restriction by the parties exchanging their equity for the royalty, will be either for a fixed number of years or until a minimum amount is paid.

The American tax payer issues are 1) whether the seller incurs an immediate tax liability at the time of the transaction, 2) the income tax treatment regarding the royalty payments as received by the seller and 3) whether the royalty payments would be tax deductible for the royalty issuer.

Assuming to some extent the answers to the above tax issues, royalties can effectively be used by employees taking over control of the business from former employers.

In the case of unfriendly takeover attempts it is possible for those seeking control of a business to condition an exchange offer on the issuance of a royalty once the control of the business was completed.

Once understood and imagination is applied, royalties become another tool in the quiver of investment bankers and others advising acquirers of companies.

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