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Let's look at the details of a Sale of Assets versus a Sale of Shares when you Sell

This article pertains to Canadian sellers than US sellers.

I worked on a deal recently where there are two very good but very different offers on the table. One was a deal to buy the "assets" of my client and the other was to buy the "shares". It was interesting to see the differences in the offers and to see how they compared in terms of *net after value to the owners*.

Conventional wisdom on the "shares versus assets" question is that as a seller you should almost always strive to get a share deal because you can get up to $913,000 of your purchase price tax free *if you have not already used any of your capital gains exemption already*. This tax-free number goes up every year by the Cost of Living increase. And if you have more than one family member owning shares you can double or triple that tax exemption. There is no doubt that selling shares is generally a much more tax effective way of selling particularly for smaller companies.

However, there are important hurdles the CRA puts in place for those *who want to get the capital gain exemption from selling shares*. Here they are:

- First your company has to be a Canadian Controlled Private Corporation (CCPC). *It can't be publicly traded, a partnership or a sole proprietorship.*
- Secondly as a CCPC, it has to *qualify f*or the capital gains exemption when the shares are sold. Qualifying is not automatic
- To qualify for the exemption the CCPC has to have:
    - *90% of the assets of the company need to be used in business operations at the time of the sale.* CRA does not want the company to be loaded down with passive assets like investments. Owners will often have to "purify" their balance sheet of passive assets before selling.
    - *50% of its company's assets have to be actively used in operations in Canada over a 24-month period.*
    - *The owners selling the shares have to have owned the shares for at least 2 years before they sell.*

I tell any of my clients who want to take advantage of their capital gains exemption that they **have to check with their accountant before we go too far down the path of the sale**. Not all CCPCs qualify for the exemption.

If you have sold the shares of your company and the sale qualifies for the capital gains exemption, then when filling out your personal tax return you calculate your capital gain by

deducting the Adjusted Cost Base of the Shares being sold from Total Purchase Price to arrive at the capital gain. (When selling a company where monitored accounts are the largest asset often the Adjusted Cost Base of your shares is any cost that incurred in buying or originating the monitored accounts in the first place. Unfortunately for many alarm dealers this adjusted cost base is next to zero.)

Moving on with the sale of shares, *50% of that capital gain is called the Taxable Capital Gain and is taxable at the shareholder's personal tax rate.* If the capital gain exemption comes into play, then it is applied against the taxable capital gain to reduce the size of the taxable capital gain. For small and medium sized companies this capital gains exemption provides a powerful reduction of taxes to be paid and is sought out by many sellers.

If an asset deal is done then not only does the Seller have to pay the capital gains tax on the sale of the assets in the company in the year the assets are sold but the Seller has to pay another tax in moving the proceeds out of the company. Having said this the seller should talk to his accountant about any balance in the company's capital dividend account.

In my practice which focuses on small and medium sized alarm, integration, fire and guard companies, it is interesting to note that the only segment where share deals are not prevalent is with alarm companies and the sale of monitored accounts particularly to the bigger buyers. There are perhaps 2 reasons why. First share deals are more time consuming and legally more expensive to do. Secondly often the bigger buyers want to be able to write off the purchase price which they cannot do when buying shares. The bottom line it is harder to get a share deal when selling monitored accounts. Interestingly enough some smaller buyers of companies with monitored accounts will often do a share deal.

So, share deals are the preferred way to go but there are strings attached. As mentioned, share deals give up more complicated agreements of purchase and sale and generally cost a little more legally to get done. Secondly some buyers of shares will lower their price (as compared to an asset deal) because they do not get the tax write off of the purchase price. Thirdly and this is important and often not understood by sellers, *buyer of shares generally expect to get all the fixed assets required to operate the business being sold included in the purchase price along with some working capital.* With asset deals the buyer specifies exactly what assets he is going to buy and will pay for each asset bought. This improves the purchase price in asset deals. In the deal I did earlier this year there was extra money to the Seller for their inventory, tech vehicles, leasehold improvements and computers all of which a buyer of shares would not generally pay for.

Sellers often don't realize that when selling shares, they will have to leave working capital in the company when they sell. Working capital here means the net of all current assets less current liabilities. This has to be a positive number at the closing date. This is called working capital. One of the biggest issues negotiated in a share deal is the actual amount of working capital that has to be left by the Seller in the company.

As it turns out with the deal mentioned above, in the asset deal offer the added purchase price the Sellers were getting from the sale of their vehicles, inventory and other fixed assets plus not having to leave working capital in the company actually almost made up for the huge tax benefit of a share deal.

Share deals are the way to go if you can get one but know that there are strings attached and some asset deals can almost make up for the tax benefits of the share deal.

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