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The Ins and Outs of Selling Shares when it comes time to sell.

Most of you know that when you sell your company, whether it is an alarm, integration, fire or guard company, the sale will either be a sale of assets or shares and that each is a different sale. Talk to your accountant to understand the difference.

Some of you will know as well that as a Canadian citizen/ taxpayer you each (including your partner in life) have access to a one-time capital gains allowance that now totals $890,000 towards the sale of the shares of a Privately Controlled Canadian Corporation (PCCC). If you own your company, it is likely that it is a PCCC but it may not qualify for the capital gains exemption. There are very strict rules in place governing which PCCCs qualify to give their owners access to the capital gains exemption if and when the shares are sold. Here are the key rules:

· When you sell the shares of your PCCC, 90% of the fair market value of the assets in the company at the time must be “active” and being used in the business. Goodwill which is often the largest asset in the business can count as being an active asset being used in the business.

· The shares of the PCCC being sold have to be held or owned by the persons claiming the tax allowance throughout the 24 months immediately prior to selling.

· Finally throughout the 24 months immediately preceding the sale, more than 50% of the FMV of the PCCC’s assets must be assets active being used in the business. This is the trickiest of all the rules

It is imperative that anybody who is considering a sale of shares of their company to access this one-time capital gains exemption talks to their accountant well before starting the sale process. It is very easy to be offside on one of the 3 rules stated above. Often a company has to “purify” their balance sheet to rid it of passive assets like excess cash and then have to wait for 2 years before selling. Or has happened to a fire company client of mine, they had to get shares of the family company into other family members’ hands to help reduce tax on the final sale.

There is very good reason to take the extra steps to make sure your company qualifies. $890,000 of tax-free purchase price for each shareholder is a huge win which makes selling shares a very attractive option. To put this into perspective I have calculated that for a Seller selling a block of say 1500 alarm accounts generating $50,000 of RMR, a buyer would have to pay a multiple of 44X in an asset deal to equate to a share deal at 36X. There is no room to spell out what gets taxed how in each type of deal but suffice to say share sales attract much less tax.

However, the facts on the ground are that now many of the bigger buyers of alarm accounts in Canada will not buy the shares of the company that holds the accounts. Not only does this often mean a smaller return

to owners from the sale of their monitored accounts but selling that alarm company may be the only chance that the owner gets to use his or her one-time capital gains exemption. It, therefore, goes to waste.

What are the reasons given by these buyers who will not buy shares? Some will not give you a reason or the person you deal with in doing the deal simply does not know. I have heard a series of far-fetched reasons.

Firstly there is the concern the buyer is worried about buying undisclosed liabilities in buying the shares. Frankly, this does not stand up to scrutiny. Share sales are done every day in Canada in all kinds of industries including the security industry without any liability after concerns. Most of the deals that I have done in the integration, fire and guard industries have been share deals with no bad aftermath. Moreover, it is easy to insert clauses into a share purchase agreement or take a small, short-term holdback to deal with undisclosed liabilities.

It is true that most times doing a share deal is slightly more complicated, time-consuming and expensive to do than doing an asset deal. The operative word in this sentence is slightly. It is not nearly as more complicated, time-consuming and expensive as many of the bigger buyers of alarm account will tell you. Again they are done all the time in other industries.

There are some guidelines to pay attention to if you want to get a share deal done. The deal does need to be a big enough deal to justify the extra time and expense in doing it. I tell my alarm clients that they have to have at least 1500 accounts- 2500 would be even better. Secondly, I like the process of taking all the other assets and liabilities out of the company before selling it. The buyer just buys the accounts. Thirdly don't balk if the buyer inserts a small, short-term holdback into the deal to cover any possible undisclosed liabilities. We are talking amounts like $25-$50,000 being held for 3 - 6 months. Finally, sellers of shares have to realize that in some or most cases you will get a smaller upfront price (but a higher tax home amount after-tax). This is primarily because buyers of shares cannot write the purchase price off after unlike with asset deals.

I do have a couple of buyers who will buy shares but the Canadian alarm industry would be better off if more buyers were prepared to buy shares.

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