

Asset Purchase Agreements and Share Purchase Agreements

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What Purchasers Need to Know

The first issue typically negotiated between a prospective purchaser and the owner of an incorporated business who is interesting in selling his or her business, is determining whether to structure the transaction as the purchase and sale of either assets or shares. The general rule is that purchasers prefer acquiring the assets of a business, while vendors favour a share sale.

Although the aforementioned preferences are commonly appropriate, it is important to consider a number of factors, including the nature of the assets, risk exposure of the business and potential tax consequences of acquiring the shares, in determining the correct approach and structure for any business acquisition. An incorrect decision at this early stage can prove costly on closing.

Here is a brief review of the key factors to consider from a purchaser's perspective in determining the appropriate structure when acquiring a business:

Transfer of Assets

In asset purchase transactions, only the assets and liabilities of the business specifically identified in the purchase and sale agreement are purchased and assumed. All other assets and liabilities of the business remain under the ownership of the vendor. This provides the purchaser with the ability to "cherry pick" the valuable assets of the business, and avoid any undesirable contracts and liabilities of the business.

In a share purchase transaction, the purchaser acquires the shares of the corporation that owns and operates the business. There is no change in the ownership of the business or of the assets, resulting in the purchaser acquiring all of the assets and

liabilities of the business (absent any specific provisions to the contrary).

Although an asset purchase may provide greater flexibility to the purchaser than a share purchase, it is important to consider the time delays and costs incurred when transferring title to the assets into the purchaser's name. Certain business assets, including land and intellectual property, may require filing documents with government authorities to complete the transfer of the assets. These filings can be associated with significant fees and taxes. In particular, transferring land in Manitoba into the purchaser's name will result in the payment of land transfer tax pursuant to Part III of *The Tax Administration and Miscellaneous Taxes Act* (Manitoba). Depending on the fair market value of the transferred land, the payment of significant land transfer tax may result in an asset purchase becoming cost prohibitive from a purchaser's perspective.

Purchasers should also be mindful of the rights of third parties under important contracts and agreements of the business. In an asset purchase transaction, the assignment of most contracts will likely require a third party's consent, which can delay the transaction due to unwilling or unresponsive third parties. However, absent a "change of control" provision in a contract, no consent or approval is required from contracted third parties in a share purchase transaction.

Liabilities

The liabilities assumed by a purchaser under an asset purchase agreement are limited to those specifically listed in the asset purchase agreement. Any unassumed liabilities of the business remain the responsibility of the seller. Consequently, due diligence costs and sleepless nights are limited in asset deals.

Generally, all past and present liabilities of the corporation continue on with the corporation after the closing of a share purchase transaction. These include the tax obligations of the corporation, current or pending litigation, and any other liabilities of the corporation, whether known or unknown on closing, whether or not they were incurred prior to the closing.

Purchasers should note that extensive due diligence of the corporation and its business operations may be required to adequately assess the risk exposure of the purchaser in a share purchase transaction. While properly drafted representations and warranties to be given by the vendor in the share purchase agreement will provide certain comfort to purchasers of shares, collecting damages from a vendor for any breach of such representations and warranties may prove costly and time consuming.

Tax Considerations

The tax treatment of the sale proceeds differs significantly between an asset purchase

and a share purchase transaction. In a share purchase transaction, the vendor's sale proceeds are taxed by Canada Revenue Agency as capital gains. Not only are capital gains taxed at a favourable rate, but the sale proceeds from certain share transactions may be eligible for the vendor's lifetime capital gains exemption. This exemption enables the vendor to receive up to \$750,000.00 of capital gains (\$375,000.00) on a tax-free basis.

In an asset purchase transaction, the lifetime capital gains exemption is not available to the vendor. Instead, the sale of the assets by the corporation may result in taxes being payable by the vendor on closing. In addition, any distribution of the proceeds from the vendor to its shareholders as dividends or income will likely attract additional taxes. On the other hand, purchasers benefit under an asset purchase transaction due to their ability to use the purchase price as their cost base for tax purposes.

Purchasers may be required to pay taxes on the assets acquired under an asset purchase agreement. For instance, purchasers are required to pay retail sales tax under *The Retail Sales Tax Act* (Manitoba) for the purchase of certain taxable assets acquired from a vendor ceasing to carry on business in Manitoba. Goods and Services Tax ("GST") may also be payable on closing depending on whether or not all or substantially all of the assets of the business are purchased.

Due to the potentially significant tax benefits available to vendors under a share purchase, it is not uncommon for a vendor to request an increased purchase price if the business is sold on an asset purchase basis. Purchasers should consider whether or not the benefits of an asset purchase transaction outweigh an increased purchase price and certain taxes payable.

Other Considerations

In addition to the considerations mentioned above, there are additional legal and tax considerations that may apply depending on the acquired business. Prior to agreeing to either structure, we recommend consulting with a business lawyer and your accountant to ensure an educated and appropriate decision is made at the outset of the negotiations.

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