Buying a Business - Part I

Transaction Structure

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Buying a business is typically a lengthy and complex process. This article is part of a series of articles that details each step of that process in order to better prepare prospective buyers. This is article 1 of 5, and deals with the buyers preliminary discussions with the seller, considerations for how to best structure the transaction and use of a "letter of intent".

Preliminary Discussions

During the preliminary stage of a potential purchase and sale transaction, a prospective buyer will have been in discussion with the seller and assessed all facets of the business potentially being acquired in order to reach an agreement on a purchase price and other fundamental terms of the deal.

Transaction Structure

One of those fundamental terms of the deal which will need to be settled is the structure of the transaction, which may proceed by way of a purchase of the assets used in operating the business or by way of a purchase of the shares of the corporation that owns the assets used in operating the business. Typically, for reasons set out below, a buyer will prefer to proceed by way of asset purchase and a seller will prefer to proceed by way of share sale. Several of the main considerations for each of the two structures are as follows:

1. Clean Break from Liabilities – In an asset purchase, the buyer will be purchasing the assets used in the business (usually free of liabilities) whereas in a share purchase a buyer is purchasing the corporation as a whole, including any past liabilities it has.

2. Certain Assets or All Assets – In an asset purchase, the buyer will be able to select which assets it wishes to purchase and which to leave behind. This flexibility is often important to buyers, as unwanted assets, contracts or employees can be excluded from the purchase. This is in contrast to a share purchase, where the buyer will purchase the entire package of assets and liabilities of the acquired corporation.

3. Taxes – One of the major reasons why sellers prefer to proceed by way of share purchase is that they may be eligible to apply their lifetime capital gains exemption to the proceeds of sale, provided their business qualifies, and as a result, pay significantly less tax on the sale, in comparison with an asset purchase.

4. Business Disruption – A share purchase does come with certain advantages for a buyer, as third party consents to the purchase are less likely to be needed and, in general, interruption to the business is minimized as a buyer simply steps into the shoes of the seller and all contracts, employees and relationships of the business remain in place.

5. Complexity – In an asset purchase, each asset being purchased will need to be transferred to the buyer as opposed to transferring ownership of the corporation that owns the assets in a share purchase. This typically leads to a more complicated legal transaction and potentially additional costs to the buyer as a result

A buyer may also choose to incorporate a new corporation to act as the purchaser. Typically this is the case, but consideration should be given to whether this is appropriate and, if so, what the optimal ownership structure of that corporation should be.

Letter of Intent

Once these terms have been settled, the parties may wish to enter into a "letter of intent" to set out on paper what has been verbally agreed to between the parties prior to spending time and incurring costs drafting the main purchase agreement. While, typically, the majority of a letter of intent is non-binding, several key provisions of the letter of intent are typically made binding and provide some comfort to both parties as they move toward documenting the deal. These include a promise by the buyer to keep any information gained in the process confidential and a promise by the seller not to negotiate a sale with any other party for a certain period of time. A lawyer experienced in purchase and sale transactions can help you determine if a letter of intent is appropriate in your circumstances.

Conclusion

Once the fundamental terms and the structure of the deal are determined the buyer can have their lawyer prepare the first draft of the main purchase agreement. Part 2 of this series of articles will focus on the nuances of that agreement.

In order to manage your risk and confidently navigate the complications of buying a business, you will need sophisticated and practical legal advice from a lawyer with specific experience in the purchase and sale of a business. I strive to provide such service in a cost-effective and timely manner, no matter the size of the transaction. Please contact me if you would like to discuss your transaction further.

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Stefan's practice covers a wide range of corporate and commercial matters, with a specific emphasis on purchase and sale transactions and financing matters for both lenders and borrowers. Stefan has experience acting for clients in purchase and sale transactions in a wide array of industries including construction, manufacturing, technology, health care and professional services.