

The most common transaction structures when consummating a sale of a business are asset sales and stock sales.

Due to different tax treatment between the two, the purchase price can differ by a fair amount depending on the structure.



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Given the tax benefits and disadvantages of the transaction structures, it is important... [more](#)

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What is an asset transaction?

In simple terms, an asset transaction occurs when the buyer purchases specifically identified assets and assumes specific liabilities. The seller retains the legal structure of the company which contains cash proceeds and the retained assets and liabilities.

The buyer generally creates a new company to house the purchased assets or rolls them into the existing company. This allows the buyer to purchase only the desired assets and assume liabilities it is comfortable with satisfying, but leaves behind undesired assets and liabilities.

How is a stock transaction different?

In a stock transaction, the buyer is actually purchasing shares of stock from the selling business shareholders. Since the buyer is purchasing the equity of the company (or a portion thereof), the buyer assumes all the assets and liabilities, including any unrecorded liabilities such as future warranty claims or potential litigation.

Tax benefits and disadvantages

If the purchase price in an asset transaction exceeds the cumulative tax basis of the assets purchased, the buyer can receive a stepped-up basis in the assets equal to the purchase price. This allows for additional future depreciation (on fixed assets such as equipment) or future amortization (on intangible assets such as goodwill) and, as such, helps reduce future taxable income and corresponding income tax expense.

However, the seller will likely have a tax disadvantage as gains on certain assets are treated as ordinary income and taxed at higher rates than assets that receive capital gains treatment. Generally, the tax benefit to the buyer is equal to the tax disadvantage to the seller.

In a stock transaction, the seller has a distinct tax advantage as the equity interest sold receives capital gains treatment. Capital gains tax rates can, at times, be 20 percent lower than ordinary income tax rates.

In certain qualifying situations, the buyer can elect to treat a stock purchase as an asset purchase under Internal Revenue Code Section 338 and receive a stepped-up basis for the assets, resulting in future tax deductions as discussed previously.

A side benefit of a stock transaction to the buyer is the ease in the transfer of non-assignable contracts, permits, licenses, etc. because they are inherently acquired in the transaction.

Given the tax benefits and disadvantages of the transaction structures, the purchase price should reflect the net differences between the parties. Therefore, it is important to evaluate the net purchase price after payment of related taxes when comparing transaction structures.

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