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Asset Sale vs. Stock Sale: What's the Difference?

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One issue during the negotiation of a business sale is deciding whether to structure the transaction as an asset sale or a stock sale. The decision is further complicated by the fact that the parties involved benefit from opposing structures. Generally, buyers prefer asset sales whereas sellers prefer stock sales. While the purpose of this article is to highlight some primary differences between the two structures, it is not intended to provide legal and (or) tax advice. Every business transaction is unique, and buyers and sellers should always consult with the appropriate professionals (attorneys and accountants) when considering a business sale structure.

An asset sale is the purchase of individual assets and liabilities, whereas a stock sale is the purchase of the owner's shares of a corporation. While there are many considerations when negotiating the type of transaction, the primary concerns for most are tax implications and potential liabilities.

If the business in question is a sole proprietorship, a partnership or a limited liability company (LLC), the transaction must be structured as an asset sale. However, if the business is incorporated, either as a regular C-corporation or as a sub-S corporation, the buyer and seller must decide whether to structure the deal as an asset sale or a stock sale.

Asset Sales

In an asset sale, the seller retains possession of the legal entity and the buyer purchases individual assets, such as equipment, fixtures, leaseholds, licenses, goodwill, trade secrets, trade names, telephone numbers, inventory, etc. of the company. Asset sales generally do not include cash and the seller typically retains the long-term debt obligations.

Accounts receivable and accounts payable may also be included in the sale.

Buyer's viewpoint:

Within IRS guidelines, asset sales allow buyers to "step-up" the company's depreciable basis in assets. Also, by allocating a higher value for assets that depreciate quickly (like equipment) and by allocating lower values on assets that depreciate slowly (like goodwill), the buyer can gain additional tax benefits. This reduces corporate taxes in future years and helps improve the company's cash flow during the vital first years. In addition, buyers prefer asset sales because they avoid inheriting potential liabilities, especially contingent liabilities in the form of product liability, contract disputes, product warranty issues or employee lawsuits.

However, asset sales may also present problems for buyers. Non-transferable assets, such as copyrights and patents, cannot be sold under an asset sale and often remain in the possession of the original owner or corporation. In addition, the buyer also has to file paperwork to incorporate or establish a legal entity in the state of operation. Then, the new company would need to re-assign all contracts, leases and permits. This process may present a challenge when dealing with government or large corporate entities, and it can slow down the process.

Seller's viewpoint:

For sellers, asset sales generate higher taxes because while intangible assets, such as goodwill, are taxed at capital gains rates, other "hard" assets can be subject to higher ordinary income tax rates. Federal capital gains rates are currently 15 percent and state rates vary (Missouri is currently 6 percent

and Kansas is 6.45 percent). Ordinary income tax rates depend on the seller's tax bracket.

Furthermore, if the entity sold is a C-corporation, then the seller faces double taxation. The corporation is first taxed upon selling the assets to the buyer. The corporation's owners are then taxed again when the proceeds transfer outside the corporation. In addition, if the company is an S-corporation that was formerly a C-corporation, and if the sale is within the 10-year built-in gain (BIG) tax recognition period, the S-corporation's asset sale could trigger corporate-level BIG, under IRS Sec. 1374.

Stock Sales

Through a stock sale, available only to S-corporations and C-corporations, the buyer buys the seller's legal entity itself and assumes ownership of the corporate stock. Most, if not all, of the accounts on the company's balance sheet are transferred to the new owner. Unlike an asset sale, stock sales do not require numerous separate conveyances of each individual asset because the title of each asset lies within the corporation.

Buyer's viewpoint:

With stock sales, buyers lose the ability to gain new depreciation on assets. The basis of the assets at the time of sale, or book value, sets the depreciation basis for the new owner. As a result, the lower depreciation expense can result in higher taxes for the buyer, as compared to an asset sale. Stock sales also cause concern for buyers and their advisors because they are accepting more risk by purchasing the company's stock, including all contingent risk that may be unknown or undisclosed. Future lawsuits, environmental concerns, OSHA violations, employee issues and others become the responsibility of the new owner. In stock sales, it is especially important for buyers to conduct thorough due diligence with a team of highly qualified professionals.

If the business in question has a large number of copyrights or patents or if it has significant government or corporate contracts that are difficult to assign, stock sales may be the better option because the corporation, not the owner, retains ownership. Also, if the company is dependent upon a few large vendors or customers, stock sales reduce the risk of losing these contracts.

Seller's viewpoint:

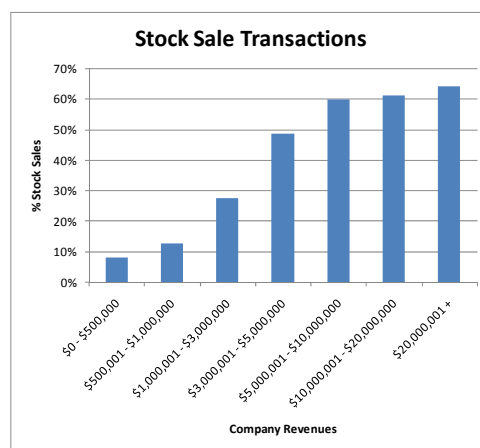
Sellers often favor stock sales because all the proceeds are taxed at a lower capital gains rate. Likewise, sellers are usually less responsible for future

liabilities, such as product liability claims, contract claims, employee lawsuits, pensions or benefit plans. However, the purchase agreement in a transaction can shift responsibilities back to a seller.

The deal structure of any transaction can have major impact on the future implications for both the buyer and seller. Many other factors, such as the company's structure and the industry, can also influence the decision. It is important for both parties to consult with their business intermediaries, legal counsels and accounting professionals early in the process to fully understand the issues and reach a decision that will produce the desired results.

Ratio of Asset Sales to Stock Sales

How common are assets sales versus stock sales? Based on an analysis of marketplace transactions from Pratt Stats database, approximately 30 percent of all transactions were stock sales. However, this figure varies significantly by company size (refer to "Stock Sale Transactions" chart below for additional details). Pratt Stats database, collecting data from SEC filings and through intermediaries across the country, focuses on mergers and acquisitions of privately held businesses. Business appraisers frequently utilize it as a source for marketplace transactions.



The Stock Sale Transactions data was pulled from an analysis of 9,194 transactions in Pratt Stat's database. The criteria for the transactions were based on the selling company being based in the United States.