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Buying or Selling a Business

Thinking of buying a new business, or selling your existing business? Here are a few points to keep in mind.

If the business is owned by a partnership or individual, selling it means selling its assets. But if the business is owned by a company, the transaction can be structured either as a sale of assets or a sale of shares in the company. Which way should you go?

Sellers generally end up paying less income tax if they sell shares instead of assets. For this reason, they often push for a share sale, and are willing to accept a significantly lower price for shares than they would be prepared to accept for an asset sale.

Buyers can also benefit from a share sale, but to a much lesser extent. For example, there’s no provincial sales tax payable on a purchase of shares, whereas PST is generally payable on most purchases of equipment.

On the negative side, buying shares means the buyer may inherit a company with undisclosed liabilities, such as pending lawsuits or reassessments for underpaid income tax. These claims can surface long after the deal has closed and the seller has received all of his money. That risk alone is often enough to outweigh any favourable pricing which the seller is prepared to put on a share sale.

A further disadvantage for the buyer in a share deal is that he loses the opportunity to allocate the purchase price to depreciable assets and thereby reduce his future tax bill. Similarly, the company being purchased may have significant accrued gains on its capital property, which can result in a hefty tax bill when these assets are subsequently sold.

For these and other reasons, buyers usually gravitate towards buying assets instead of shares wherever possible. Reconciling these competing interests of buyer and seller is a key part of negotiating a fair agreement, and should be guided by advice from both your lawyer and accountant. Otherwise, you may inadvertently commit yourself to a transaction structure that is far from ideal.

Once the parties have loosely settled on the key business points, it is normal for them to sign a letter of intent which records the points agreed to and gives the buyer the opportunity during a defined period to take a closer look at the business records. This is called a “due diligence” review. If the buyer doesn’t like what he sees, he can call off the deal. The buyer normally agrees to keep strictly confidential any information he acquires during the course of such review. If the buyer is satisfied with the results of his review, then the parties normally proceed with settling the terms of a formal agreement.

There are numerous key areas that have to be addressed in the formal agreement. For example, the buyer will usually want a “non-compete” clause that restricts the seller from competing with

the buyer after the deal closes. Such clauses have to be carefully worded, since if they "over-reach" what a court would consider reasonable (in terms of time frame, geographical area or scope of activities), they can held unenforceable. The formal agreement should also spell out the seller's representations and warranties concerning the business and (if applicable) the company, and the buyer's recourse if there is a breach of those clauses.

Your legal advisor can help guide you through the maze of available options to reach the best deal possible in your particular circumstances.

This article was written by Janice Mucalov, LL.B. with contribution by James MacLean of MILNE SELKIRK. A version of this was previously published in the Langley Times. ***Copyright by Janice Mucalov. "You and the Law" is a registered trade-mark.*** ***Please call James MacLean (604-882-5015) if you have any questions or for legal advice.***