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Advice that counts

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Quick Facts: Buying & Selling a Business

When you are buying or selling a business, there are two options – to buy/sell the assets of the business (for a sole proprietorship/partnership) or to buy/sell the shares of the company (for an incorporated company). The first is known as an asset sale and the second is a share sale.

- In an asset sale, only the assets of the business are purchased. These assets can include furniture, equipment, accounts receivable, inventory and leasehold improvements.
- The difference between the fair market value (FMV) of the assets – FMV being the price an unrelated person would pay for the asset in its present condition – and the price that you pay for these assets is known as goodwill.

SNAPSHOT: BUYING A SMALL GROCERY STORE

	FMV
Equipment	$ 50,000
Delivery van	$ 20,000
Inventory	$ 90,000
Leasehold improvements	$ 10,000
Total FMV of assets	$170,000
Price paid	(200,000)
Goodwill purchased	$ 30,000

Main advantage of an asset purchase from a buyer's perspective:

- You do not inherit any of the liabilities of the existing business

Risk of an asset sale from a seller's perspective:

- If there is a difference between the proceeds received for an asset and the current depreciated value, you may be faced with recapture income. For example, if you sell an asset that is on your books at $2,000 for $2,500, you will be required to report income of $500. In addition, you are required to pay tax on the amount of goodwill in the valuation.

Main advantage of a share purchase from a buyer's perspective:

- The ability to purchase not only the assets of the business but rights to the name as well

Risk of a share purchase from a buyer's perspective:

- You inherit the liabilities. If the company has been involved in labour, tax or legal issues, you will inherit these too. For example, if there is an audit of the books and it is determined that there are taxes due for a year prior to you owning the business; you will be liable to pay those taxes. You may have a clause in your purchase agreement that says the previous owner will be responsible for those taxes but you may have difficulty enforcing the clause.

Main advantages of a share purchase from a seller's perspective:

- You may qualify to pay no tax on the proceeds. Every resident is currently eligible for a $800,000 lifetime capital gains exemption (adjusted annually). As an example, if you bought your shares for $1 and sold them for $20,000, you would pay no tax on the sale.

This overview is meant as a summary of the basics. If you are considering buying or selling a business, it's extremely important to get good legal and accounting advice, as the structure of a purchase or sale can significantly impact your tax situation.