

There are two basic methods of structuring the sale of an incorporated business. You can either sell the net assets of the business or sell the shares of the incorporated entity. The decision as to the structure of the transaction will depend on the circumstances surrounding the sale as well as the negotiating ability of the vendor and purchaser. This article has been prepared to highlight those issues that need to be considered when deciding to purchase or sell a business to a third party.

The extensive issues surrounding business succession to family members (such as which members, if any, are prepared to manage the business, non-active shareholders and estate equalization to name a few) as well as the various methods of valuing a business are beyond the scope of this article.

HIGHLIGHTS

- Bumped-up tax cost of assets purchased
- Availability of \$750,000 capital gains exemption
- Minimizing land transfer tax, GST and PST
- Employee considerations

SALE OF ASSETS

When purchasing assets necessary to run a business you may purchase tangible assets such as machinery and equipment as well as non-tangible assets such as goodwill and customer lists. If you purchase these assets from an existing corporation you will be able to choose which assets to acquire and which liabilities, if any, to assume. This may not include all the assets and liabilities that currently exist within the incorporated entity and any assets and liabilities that are not purchased will remain within the corporation.

For both the purchaser and the vendor the total purchase price will be allocated to the various assets based on their fair market value (including amounts allocated to goodwill). The **purchaser** may be an individual or a corporation and the cost of the various assets and their ongoing deductibility for tax purposes will be based on the purchase price paid for those assets as opposed to the vendor's original purchase price.

From the **vendor's** perspective, there will be two levels of taxation. First, when the corporation sells its assets, any income, gain or loss from the disposition of these assets will be calculated and taxes will be payable by the corporation on its taxable income. The second level of taxation will occur when the corporation eventually distributes the net after-tax proceeds to its shareholders. If a capital gain is realized on the disposition of certain assets, consideration should be given to paying out a capital dividend (the tax-free portion of the capital gain), to the extent that one is available, since a subsequent capital loss could remove the ability to pay out this tax-free dividend.

SALE OF SHARES

From the **vendor's** perspective it is often preferable to sell the shares of the corporation because any gain on the sale of the shares will be treated as a capital gain and subject to tax on only 50% of the capital gain (taxable capital gain). In addition, because the sale of shares results in the vendor ceasing to own the company, or any of its assets, there will be no on-going filing requirements or issues to deal with.

When a **purchaser** buys shares of a business they assume the tax position of the vendor including the tax cost of the underlying assets of the company. One benefit of this structure is the ability to utilize any previous tax losses that have accumulated. However the purchaser will also be subject to any undisclosed or contingent liabilities of the corporation that may include additional taxes owing as a result of previous tax filings; failures to remit PST, GST or

other source deductions, and finally, may incur additional costs as a result of future claims from suppliers, customers or employees.

Capital Gains Exemption

Where a corporation meets the requirements of a **Qualified Small Business Corporation**, an individual may realize up to \$750,000 of capital gains on the sale of their shares on a tax-free basis. Because the requirements are extremely complex we recommend that you speak with your tax professional to ensure that the corporation qualifies for this purpose and your personal tax situation makes best use of the capital gains exemption.

OTHER ISSUES

In addition to the income tax implications noted above there are many non income tax issues that need to be considered:

Sale of assets

- Land transfer tax may apply to the sale of certain assets such as land and buildings
- Most asset sales will be subject to Goods and Services Tax (GST) and Provincial Sales Tax (PST)
- The purchaser may offer employment to existing employees or set up a new work force
- The vendor will be responsible for dismissing employees and must comply with various employment standards relating to notice, severance pay and employment contracts.

Sale of shares

- Does not attract land transfer tax, GST or PST
- Potential cost of dismissing, re-training or litigating with those employees not deemed suitable

CONCLUSION

There are a number of factors to consider when structuring the purchase and sale of a business. In most cases, vendors will prefer to sell shares due to the preferential tax treatment whereas purchasers' tend to prefer purchasing net assets. In all cases, professional and independent legal and tax advice should be obtained to ensure all the benefits and pitfalls have been addressed.

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