

BUYING OR SELLING A BUSINESS - BEWARE

The first thing that must be determined when you go to buy or sell a business is whether or not it will be done via an asset sale or a share sale. This decision will have a significant impact on the immediate costs incurred as well as on the ongoing operation of the business.

In a perfect world, legal advice would be sought before the deal is made but not everyone lives in a perfect world? Often, after the deal is made and the lawyer or the accountant starts telling the parties all about the ramifications of the deal and just what it is that they have actually agreed to, one or the other wants to run away or renegotiate. The subsequent inability to get the other side to agree is often a great source of business for barristers.

Generally speaking, it is to the buyer's advantage to buy assets while it is to the seller's advantage to sell shares. In an asset purchase, the buyer can pick and choose which assets are being sold and which obligations and liabilities are being assumed. In a share purchase, the purchaser is buying the shares of the company that owns the assets and has the obligations. Unless steps are taken to remove assets or liabilities from the company before closing, all the assets and all the liabilities of the company (warts and all) are transferred.

It is advantageous for the seller to sell shares instead of assets if the business has a lot of long-term permanent employees but the buyer is not going to want to have to assume the obligations that go along with them without a corresponding reduction in price to make up for it. This is especially true if the buyer plans on firing a few or all of the employees once they take over the business.

A long-term employee may be entitled to up to 18 – 24 months of severance pay if they are terminated without cause. What new buyer wants to pay out a year and a half of salary to a guy who will never do a lick of work for him? The alternative is to give such an employee 18 months notice that they are going to get the axe but you can imagine how hard they will work for the next year and a half once you spring that bit of bad news upon them.

Usually, the deciding factor of how the deal will be structured will be the income tax consequences of the various methods but there are other considerations as well. Real estate commissions and conveyancing costs can play a significant role in the decision. Social services taxes must be paid on the transfer of chattels and personal property. GST and registration costs must be paid on trademark assignments and registered user agreements. The biggest cost, however, is often the cost of transferring real estate.

For example, if the company is in, say, the car wash business and its major asset is the property on which the car wash sits, there may be some serious costs and taxes incurred to transfer title. The Property Transfer Tax in BC is 1% of the first \$200,000 and 2% thereafter. For a piece of property worth a million dollars, the PTT alone is \$18,000.00. In such a situation, it may make a lot more sense to buy shares. Then the owner of the property stays the same (no transfer and, thus, no PTT) but the owners of the company that owns the property change. Of course, if the property was originally bought for \$500.00 in 1972, someone is going to have to pay capital gains tax on the difference if it ever is sold. You can see why it is wise to get accountants and lawyers involved in the process fairly early on.

The foregoing is not meant to be an exhaustive list of all the things you should think about or consider before buying or selling a business. There are lots of other things to worry about as well that can cost you a lot if you goof up. Are there any minority shareholders and, if so, how do they feel about selling out? How much of the purchase price will be allocated to assets (that are depreciable) versus goodwill (that cannot be written off against income)? Is there a collective bargaining agreement in place and, if so, how does the union feel about the sale? Will there be personal guarantees involved? What are the GST consequences? Will the vendor allow vendor financing and if not, why not?

If you don't understand some of the above or if you cannot answer any of the questions in the preceding paragraph, you really should see a lawyer about it. If you don't, you may have to see a barrister or a trustee in bankruptcy about it.