

Basic Deal Structures

Stock Purchase vs. Asset Purchase

Each transaction's structure can potentially have many elements. One fundamental element is whether the deal will be structured as a stock purchase or an asset purchase. The decision as to which is best can be a difficult one which is further complicated by the fact that what is good for one party is generally bad for the other. Oftentimes, other elements of the deal structure are adjusted in an attempt to make up for this fact.

Stock Purchase

Initially, it should be noted that when we discuss a Stock Purchase we are really referring to the purchase of the entire entity which most often involves a corporation's stock. To the extent that the transaction involves another type of entity such as a **Partnership** or a **Limited Liability Company**, the term that is used will be slightly different. In a Stock Purchase, all of the outstanding shares of stock of the business are transferred from the seller to the buyer. Although there may be cases where a party to a contract with the business has a right to object, the buyer in effect steps into the shoes of the seller, and the operation of the business continues in an uninterrupted manner. Unless specifically agreed to, the seller has no continuing interest in, or obligation with respect to, the assets, liabilities or operations of the business.

From an accounting perspective, the business's assets and liabilities are not adjusted, they continue to be carried and/or depreciated in the same manner as before the transaction. From a tax perspective, the seller recognizes a gain or loss based on the difference between the sales price and his or her current basis in the stock.

Asset Purchase

In an Asset Purchase, the seller retains ownership of the shares of stock of the business. The buyer must either create a new entity or use another existing entity for the transaction. Only assets and liabilities which are specifically identified in the purchase agreement are transferred to the buyer. All of the other assets and liabilities remain with the existing business and thereby the seller. Asset Purchase transactions are generally more complicated because ownership of the assets and liabilities and any related contracts must actually be transferred, sometimes through the filing of documents with governmental offices. This may also involve additional fees. In addition, a transaction involving the sale of substantially all of the assets of a business may be impacted by state "Bulk Sales" rules which can require notification of all of the creditors of a business. Other considerations include the possible transfer of the corporate name, and the rehiring of employees by the buying entity.

From an accounting perspective, the buyer records the assets and liabilities at the fair market value assigned to them as part of the transaction. This may increase or decrease the carrying value and/or amount of annual depreciation with respect to individual assets and liabilities. From a tax perspective, the existing business recognizes a gain or loss based on the difference between the sales price and the carrying value of the assets and liabilities.

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Which Structure to Choose

Sellers will generally prefer a Stock Purchase because it allows them to completely step away from the business. They are generally completely free from any future obligations with respect to the business. In addition, a seller is usually entitled to pay taxes at the lower capital gains rate in a Stock Purchase. In an Asset Purchase involving a corporation, the seller may face **double taxation** because the corporation will pay tax on the gain from the sale of the asset and then pay tax when and if the proceeds are distributed to the selling owner.

Conversely, a buyer generally prefers an Asset Purchase. The buyer knows exactly which assets are being acquired and which liabilities are being assumed. This is particularly important to a buyer if the business has a significant number of actual or potential liabilities, and it is difficult to quantify the amount of those liabilities. A buyer should generally perform additional due diligence in the case of a Stock Purchase because of these assumed liabilities. As discussed above, a buyer may also benefit from an Asset Purchase if a purchased asset's value has increased because a buyer is allowed to write up the basis of an asset to the fair market value paid for the asset. Increased tax depreciation may then be claimed which leads to lower taxable income and lower taxes.

As this discussion indicates, the decision on whether to structure a transaction as a Stock Purchase or an Asset Purchase involves numerous factors which can impact the buyer and the seller quite differently. Both parties should consult their professional advisors at a very early stage of the process to insure that they fully understand the issues prior to making their decision. If you need to consult a lawyer or accountant to help you make these decisions, MET Advisors, Inc. can help.

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