

Asset Sale or Share Sale? Key Considerations About the Legal and Employment Implications

June 20, 2023

When it comes to selling a business, there are two primary methods: an asset sale and a share sale. Both have their own advantages and disadvantages, and it is important to understand the key legal differences between the two. For the purposes of this article, we are assuming that the entities involved are corporations, as opposed to other business structures such as a sole proprietorship or partnership.

Asset Sale

In an asset sale, the buyer purchases specific assets and may agree to assume specific liabilities of the business rather than buying the entire company. The assets can include items such as equipment, inventory, goodwill intellectual property, and contracts. The shareholders of the selling corporation retain ownership of the legal entity. The buyer may choose to use an existing corporation or create a new entity to acquire the purchased assets.

Generally speaking, a buyer will prefer to acquire a business by way of an asset sale. A primary advantage of an asset sale is that the buyer can pick and choose which assets and liabilities they want to acquire, and they are not responsible for any unknown or undisclosed liabilities of the seller. This can help mitigate the risk for the buyer. Another advantage of an asset sale are the tax benefits available to the buyer. The buyer may be able to depreciate the assets over time, reducing their tax liability.

From an employment law perspective, the buyer is not automatically liable for the seller's employees in an asset sale. Employment contracts, along with any related rights and obligations, remain with the seller. However, if the buyer decides to take on any of the seller's employees, they must negotiate new employment contracts with them. If the buyer does not want to hire any of the seller's employees, any obligations relating to the seller's employees remain with the seller. This can result in termination pay and other obligations for the seller.

There are also some potential disadvantages to an asset sale. For example, if the business has contracts or leases that are critical to its operations, the buyer may need to renegotiate the terms of those agreements with the third parties. Additionally, transferring certain assets, such as intellectual property, can be complex and time-consuming.

Share Sale

In a share sale, the buyer purchases the shares of the corporation that owns the business from the shareholders. As a result, the buyer acquires all of the assets and liabilities of the company, including any unknown or undisclosed liabilities. Upon the acquisition of the shares, the directors and officers of the corporation will typically resign and be replaced by new directors and officers of the buyer's choosing.

A seller will typically prefer a share sale over an asset sale, as the seller may, depending upon the circumstances, be able to take advantage of the lifetime capital gains exemption.

An advantage of a share sale relates to the assignment of contracts with third parties. In an asset sale, any third-party contracts being assumed by the buyer must be assigned from the seller to the buyer, which may trigger consent requirements and administrative fees payable to the third party. In a share sale, the legal entity, and thus the party to

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the contract, remains the same. As such, there are usually no consent requirements or administrative fees payable, unless the contract provides that a share sale (also referred to as a “change of control”) is the equivalent of an assignment.

When the buyer acquires the legal entity that owns the business as part of a share sale, they will inherit its employees. All existing employment contracts, rights, and obligations transfer to the buyer. This means that the buyer must be aware of any employment-related issues, such as employee benefits, pensions, and other obligations, and ensure that they are willing to take them on. Additionally, if the buyer plans to make any changes to the employees' contracts or terms of employment, they must follow any applicable employment laws, such as providing notice and consideration.

There are some potential disadvantages to a share sale. The buyer may be liable for any unknown or undisclosed liabilities of the seller, which can be difficult to quantify and may lead to significant financial exposure. Additionally, there may be employment-related issues, such as changes in employee contracts or redundancies, which may need to be addressed. The due diligence process is typically more extensive than on an asset sale, as searches need to be conducted both on the target corporation and all selling shareholders to ensure that the assets in the target corporation and the shares being sold by the shareholders are unencumbered.

Conclusion

In summary, both asset sales and share sales have their own advantages and disadvantages. An asset sale can provide greater flexibility and reduced risk for the buyer, while a share sale can provide significant tax benefits to the seller. It is important to consider the specific circumstances and nature of the business and the goals of the buyer and seller when determining which method is most appropriate. Additionally, seeking legal and tax advice can help ensure a successful and smooth transaction.

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