"Key Tax Considerations: Deciding Between an Assets vs Stock Sale"

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Subject to compliance with IRS guidelines, asset sales allow Buyers to "step-up" their depreciable basis in the assets it is purchasing (which emphasizes the importance of the allocation of the purchase price among the purchased assets). A higher acquired tax basis, which usually results from the purchase price paid, is beneficial to the Buyer for purposes of amortization and depreciation. This reduces taxes and improves the Buyer's cash flow during the vital early years after the purchase.

For Sellers, asset sales tend to generate higher taxes because while intangible assets, such as goodwill, are taxed at capital gains rates, other "hard" assets can be subject to higher ordinary income tax rates based on recapture of depreciation previously taken by the Seller. This is particularly the case for businesses that have significant equipment, such as manufacturing, restaurants, construction, health care, and transportation.

Depending on whether the Selling entity is a "C" Corporation or an "S" Corporation (an election to be treated as a pass through entity for tax purposes), there may also be the very unpleasant prospect of the Seller side of the transaction facing double taxation. The selling entity is first taxed upon selling the assets to the Buyer. The selling entities' owners are then taxed again when the proceeds are distributed to the selling entities' owner(s). The double taxation dilemma may not be a concern when the selling entity is an LLC, depending upon how it has previously elected to be taxed.

In Contrast, Stock Sales Generally Are More Favorable to Sellers Tax Wise

Sellers often favor stock sales because generally the proceeds are taxed at a lower capital gains rate, and for "C" corporations the corporate level taxes are bypassed. In other words, the sale of stock alternative is generally more advantageous to the selling shareholders because only one tax will be imposed at the shareholders' level (and usually at long-term capital gains rates).

However (with some limited exceptions), with stock sales, Buyers lose the ability to gain a stepped up basis in the assets and thus do not get to re-depreciate certain assets. The adjusted basis of the assets at the time of sale sets the depreciation basis for the new owner. As a result, the lower depreciation deduction can result in higher future taxes for the Buyer, as compared to an asset sale.

Sales Tax Ramifications of Deals

A California sales tax is generally not imposed on a stock sale transaction, but may be imposed with respect to the sale of tangible personal property in a sale of assets (with various exceptions). The greater the percentage of the sale which is allocated to equipment, the more significant the issue of sales tax liability becomes.