

Structuring Your M&A Transaction

Asset Purchase Versus Stock Purchase

By: Elizabeth A. Resteghini
July 11, 2019



When you are ready to buy or sell a company, it can feel like all the pieces are moving a million miles a minute. Whether you are the buyer or the seller, there are a number of considerations to keep in mind when structuring the transaction. In addition, determining the structure may be challenging as the buyer and the seller typically have competing interests. This article will walk through some of the chief reasons that the buyer or the seller might prefer to structure the transaction as an asset purchase or stock purchase.

Asset Purchase

In an asset purchase, the buyer purchases certain agreed-upon assets and assumes certain agreed-upon liabilities of the company being acquired (the “Target”). The Target’s stockholders typically retain ownership of the Target but liquidate the Target after the sale and receive the proceeds of the sale in the form of liquidating distributions from the Target. The buyer generally either creates a new entity or uses an existing entity to purchase the Target’s assets and continue the Target’s business.

Typically, it is the buyer who prefers an asset purchase.

Advantages:

- **Target Liabilities:** The buyer assumes only the liabilities that are designated in the purchase agreement as assumed. For example, these liabilities might include equipment, customer contracts, facilities, inventory, and goodwill. All other liabilities not assigned in the asset purchase agreement, including unknown or undisclosed liabilities, typically remain with the Target.¹
- **Basis “Step Up”:** If the Target is a C corporation (or an S corporation), a buyer may prefer to structure the transaction as an asset purchase so that it can “step up” the tax “bases” of the Target’s assets. By stepping up the tax bases, the buyer can take greater depreciation and amortization deductions on, and report less gain on resales of, the purchased assets.
- **Cash-Free:** The buyer generally does not have to directly or indirectly purchase the Target’s cash.

An asset purchase, however, can be more complicated than a stock purchase and can be disadvantageous to the seller from a tax standpoint.

Disadvantages:

- **Third Party Consents:** An asset purchase may trigger anti-assignment provisions of the Target’s contracts with third parties. The buyer typically requires the Target to obtain

consents of the third parties to assignments of the contracts. Obtaining consents can be a timely process, especially for government contracts and leases. In addition, the third parties or the buyer may want to re-negotiate transferred contracts.

- **Re-titling of Assets:** The transfer of ownership of purchased assets will require them to be re-titled or re-registered in the name of the buyer, such as titles to real estate, equipment and company vehicles.
- **Employee Benefit and Payroll Changes:** In an asset purchase, employee benefit plans need to be terminated and new ones entered into in the name of the buyer. New employee offer letters should be sent to employees that the buyer desires to keep, and payroll will need to start fresh. Because employees need to be fired then rehired, employees will also need to be paid out for earned vacation time. This can be quite costly depending on the number of employees and how much vacation time has accrued.
- **Post-Sale Liquidation:** After the transaction, the Target's stockholders have to wind up and liquidate the Target. The seller needs to liquidate any assets not purchased and pay any liabilities that have not been assumed.
- **Tax Results to Target and its Stockholders:** If the Target is a C corporation, it will be subject to tax on its gain from the sale, and the stockholders will be subject to tax on gains they have when they receive the net proceeds of the sale from the Target. Even if the Target is an S corporation or limited liability company, an asset sale can require the Target's owners to report some of their income from the sale as ordinary income rather than as capital gain.

Stock Purchase

In a stock purchase, the buyer purchases the stock of the Target from the Target's stockholders. Because the buyer purchases the Target's stock from the Target's stockholders, the Target continues to operate after the transaction but with the buyer in control.

Typically, it is the Target's stockholders who prefer a stock purchase.

Advantages:

- **Tax Results to Target and its Stockholders:** In a purchase of stock of a C corporation (or an S corporation), gain is taxed only once at the stockholder level and is capital gain.²
- **Third Party Consents:** Consents to assignments of contracts are generally not required unless the contracts contain specific language allowing for termination upon a change of control or a change in ownership. The benefit is that there are typically fewer contracts for which the parties will need to obtain third-party consents.
- **No Re-titling of Purchased Assets, etc.:** The seller's assets typically do not need to be re-titled in the buyer's name. There is also no post-sale liquidation that needs to occur, because all assets are purchased in a stock sale. Employee plans can typically remain in place, and employees do not need to be fired then rehired, thereby diminishing the amount of paperwork to effect the transaction.

A stock purchase may, however, have some disadvantages for the buyer as compared to an asset purchase.

Disadvantages:

- **Target Liabilities:** Because the buyer purchases the Target's stock from the Target's stockholders and the Target continues to operate after the transaction but with the buyer in

control, the buyer in effect bears the burden of the Target's liabilities, except to the extent the seller has agreed to remain responsible for them under the purchase agreement.

- **Minority Stockholders:** In a stock sale, minority stockholders could in theory delay a transaction. Perhaps they are difficult to contact or decide not to sell their stock. However, this can typically be resolved by taking the extra step of doing a reverse merger (where buyer forms a merger subsidiary that merges into the Target).
- **No Basis "Step Up":** If the Target is a C corporation (or an S corporation), there is no "step up" in the tax bases of its assets as a result of a purchase of its outstanding stock.

In general, buyers prefer an asset purchase transaction because they can limit the liability they assume from the Target. Sellers typically prefer a stock purchase structure because it saves them time and money since they do not have to re-title transferred assets or seek consent for contracts that contain standard anti-assignment language.

For more information, please contact [Liz Resteghini](#).

Footnotes.

1. Subject, however, to theories of potential successor liability or fraudulent conveyance.
2. Of course, in theory, a buyer should not be willing to pay as much for stock as it would pay for assets given the inability to step up the tax bases of the Target's assets in a stock purchase.