

Asset vs. Stock Sales 101: The Very Basics

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The purchase and sale of a business can be a daunting task; it often involves many unfamiliar issues, even to an experienced business owner or a potential buyer. One issue that is important to address early on is what, in fact, is being bought and sold: Is it the ownership interest of the business entity itself (in most cases, the sale of the “stock” referred to as a “stock purchase”), or are only the assets of the business being transferred to the new owner (an “asset purchase”) without a transfer of ownership of the actual business entity?

Understanding the basic differences assists buyers and sellers as they negotiate the terms of a sale that are most beneficial to them. It also helps them avoid the pitfall of agreeing to an asset or stock purchase early in the negotiations without understanding the long term ramifications.

As a general rule sellers prefer stock purchases, while buyers prefer asset purchases. Examining the differences between stock purchases and asset purchases will help to explain why this is the case.

A stock purchase is a method of acquisition where the stock (or other ownership interest) of a business is purchased by a new owner. There are several advantages to a stock purchase from the seller’s perspective. First, this type of transaction may be an opportunity for the seller to “walk away” from the business. This is because in a stock purchase the buyer steps into the shoes of the seller, freeing the seller from the majority of the obligations associated with the past and future business operations. A second advantage of a stock purchase, from the seller’s perspective, is the tax implications of a stock purchase when compared with an asset purchase. While this article cannot provide individualized tax advice, a stock purchase is generally advantageous for a seller because of the benefit from capital gains tax rates.

Although a buyer generally prefers an asset purchase, one factor that may lead a buyer to favor a stock purchase is the nature of the contracts held by the seller. Since the buyer essentially steps into the shoes of the seller in a stock purchase, it is often much easier for the buyer to maintain contracts, such as real estate lease agreements, if a transaction is structured as a stock purchase. Our firm has worked on numerous business sales that were structured as stock transactions for the primary purpose of maintaining the seller’s contracts. In considering this strategy, it is important to examine the underlying contracts to verify that the sale is structured to allow for this transition.

In contrast to a stock purchase, in an asset purchase the buyer and the seller choose the assets of the business to be sold to the buyer while the selling entity remains intact. The buyer typically purchases the majority of the seller’s assets such as equipment, accounts receivable, client lists, and other items. From the buyer’s perspective, an asset purchase is generally preferred because it allows for certain tax advantages. An asset purchase also allows the buyer to better pick and choose those assets which it wishes to purchase (e.g., a particular piece of equipment) while excluding those liabilities which it does not wish to assume (e.g., an unfavorable contract or pending litigation). Although a buyer generally prefers an asset purchase, it may be willing to agree to a stock purchase if there are valuable contracts that can be more easily assumed by the buyer via a stock purchase.

Since every business purchase and sale involves a unique set of circumstances, it is important to closely analyze each transaction to determine whether a stock purchase or an asset purchase is more desirable to a particular party based upon the above considerations, applicable state law and other factors.