Mergers & Acquisitions
The Basics

Following is a Chart
Comparing and Contrasting
Asset and Equity Sales
taken from my book:

"Buying and Selling a Business
A Practical Guide
to the Acquisition and Sale Process"

The Chart was prepared in collaboration with Consulting Firm:

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EvansWaite specializes in brokering the sales of, and providing expert consulting services for, equipment and special events rental operators throughout North America.

They are truly experts in this arena, having authored nine (9) different books for the American Rental Association on different issues faced by Rental Operators.

The purpose of the following chart is to provide a set of basic guidelines for comparing the relative benefits of the different types of business sales and purchases (assets versus equity), largely from a tax perspective

Asset and Stock Sales Compared

The following is a chart comparing and contrasting some of the major issues encountered by both buyers and sellers in Asset Sales and Stock Sales. It is provided for informational purposes only and should not be viewed as a substitute for the advice of trained legal and tax counsel. ***Consult professional advisers for specific information regarding the following issues.***

ASSET SALE		STOCK SALE	
SELLER	***BUYER***	***SELLER***	***BUYER***
Assets-Seller identifies specific assets to sell.	**Assets**-Buyer purchases specified assets only.	**Assets**-All assets of the Seller-entity are transferred to Buyer automatically because Buyer actually purchases the Seller (and thereby gets everything Seller owns) in the sale.	**Assets**-Buyer purchases all stock of Seller-entity. Buyer must be careful to verify the entity owns all of the assets Buyer hopes to obtain (i.e., assets are not owned by a different entity and split-rented, floor planned or leased).
Corporate Entity- Seller retains the corporate entity.	**Corporate Entity**- Buyer does not take over the corporate entity.	**Corporate Entity**- Seller relinquishes and Buyer takes over corporate entity, preserving: tax entity, depreciation*, tax year, carry forwards, tax election, etc. *Note: depreciation is not assumed by Buyer when a 338 election has been made.	**Corporate Entity**- Buyer takes over corporate entity, preserving: tax entity, depreciation*, tax year, carry forwards, tax election, etc. *Note: depreciation is not assumed by Buyer when a 338 election has been made.
Liabilities-Liabilities remain with Seller, however, liens on assets will continue to exist against the assets unless cleared (paid off) at or prior to Closing.	**Liabilities**- Buyer does not assume liabilities, but the assets themselves may be liened. Buyer must check the UCC (Uniform Commercial Code) records of the State of Seller's incorporation and principal place of business, and to be safe, the state where the assets are located, to ensure no liens have been filed of public record. If liens have been filed, the	**Liabilities**- Seller is relieved from all liabilities*; all liabilities are transferred to Buyer in the sale. *Note #1: if Seller owns land, he may still be responsible for environmental problems years after the sale, so Seller must get a clean environmental report to avoid this problem.* *Note #2: if any individual owner of a*	**Liabilities**- Buyer assumes all liabilities*; known and unknown. *Note: if Seller owns land, he may still be responsible for environmental problems years after he has sold the land. In addition, Buyer may be held responsible for any environmental problems even if Buyer does not purchase the property because liability under CERCLA runs to*

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	lienholder's rights will continue after Closing if the debt is unpaid, and if Buyer and/or Seller fail to pay the amounts due, the lienholder will be entitled to foreclose on the liened assets.	*Seller-entity has personally guaranteed any obligation(s) of the Seller-entity, such personal guarantee(s) will not automatically be released.*	*"all owners and occupants" jointly and severally (meaning each can be held liable for the entire cost, not just his proportionate share). Buyer should obtain a Phase I environmental audit (clean) prior to purchase.*
Seller Representations and Warranties- Seller makes/provides some, but generally not as many as in a stock deal.	**Seller Representations and Warranties**- Buyer receives some, but generally not as many as in a stock deal.	**Seller Representations and Warranties**- Seller must make numerous reps and warranties.	**Seller Representations and Warranties**- Buyer is protected by many reps and warranties. The risk assumed by Buyer is greater than in an asset purchase because all liabilities of the Seller-entity are carried over in the sale unless paid at Closing. So, Buyer generally feels entitled to greater protection.
IRS Form 8594- Seller and Buyer complete and file their own IRS form 8594 with their annual tax returns. Form 8594 shows allocation of purchase price among Seller's assets. Seller's allocation MUST match Buyer's allocation.	**IRS Form 8594**- Seller and Buyer complete and file their own IRS form 8594 with their annual tax returns. Form 8594 shows allocation of purchase price among Seller's assets. Seller's allocation MUST match Buyer's allocation.	**IRS Form 8594**- Individual shareholders report the capital gain/loss from the sale of their stock on their tax returns. Seller completes IRS form 8594 if Seller makes section 338 election.	**IRS Form 8594**- Buyer completes IRS form 8594 if Buyer makes a section 338 election.
Depreciation on Equipment- Depreciation remains with Seller; Seller's cost basis is not assumed by Buyer.	**Depreciation on Equipment**- Buyer allocates part of purchase price to equipment. This amount is Buyer's new basis in the equipment and he starts depreciating from here.	**Depreciation on Equipment**- Cost basis in equipment and accumulated depreciation is transferred to Buyer.	**Depreciation on Equipment-** Buyer inherits Seller's cost basis and depreciation on equipment. The amount Buyer paid to Seller is allocated to his basis in the stock of the Seller-entity (rather than the assets).
Tax Consequences- **On Depreciated Equip-** Seller must pay income tax (at income tax rates) on the amount of depreciation recapture on capitalized	**On Depreciated Equip-** Buyer allocates part of purchase price to equipment. This amount is Buyer's new basis in the equipment and he	**Tax Consequences**- Seller pays capital gains tax on the difference between the purchase price and Seller's basis in the stock (the amount the stock cost Seller), without regard to how it is allocated.	**Tax Consequences**- Buyer cannot deduct any portion of the price Buyer pays for the stock as a business expense. The amount the Buyer pays for the stock is Buyer's beginning basis in the stock.

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equipment sold. (Depreciation recapture is defined as: the *lesser* of (i) sale price of equipment minus Seller's basis in equipment, or (ii) the amount of accumulated depreciated on the equipment.) Seller pays capital gains tax on amounts over this. **<u>On Depreciated Personal Property (other than rental equipment)-</u>** Seller must pay income tax on depreciation recapture on capitalized personal property (NOT including rental equipment) sold (e.g., computers, desks, chairs, tables, etc.). **<u>On Depreciated Real Property</u>**- Seller must pay tax on depreciation recapture on any depreciated real property sold (e.g., depreciation recapture tax rate on real property for 2007 is 25%). *Check with your accountant for current tax rates.* **<u>On Retail Merchandise and supplies-</u>** Seller pays income tax on the difference between cost basis and purchase price allocated to retail merchandise. (Typically Seller sells retail merchandise and supplies at	starts depreciating from here. **<u>On Depreciated Personal Property (other than rental equipment)-</u>** Buyer allocates part of purchase price to personal property (other than rental equipment). Buyer pays a use tax on these items at time of purchase. This use tax is charged at the local sales tax rate (generally 4-8%). *Note: in some cases, Buyer may elect, under IRC 179, to write off a certain amount paid for depreciated personal property as expenses in the first year. Check with your accountant to determine the current year amount allowed by IRC 179.* **<u>On Depreciated Real Property</u>**- Buyer allocates part of purchase price to real property. This amount is Buyer's new basis in the real property and he starts depreciating any depreciable real property from here. **<u>On Retail Merchandise and supplies</u>**- Buyer allocates part of the purchase price to retail merchandise and supplies. As these items are sold by Buyer, he deducts them as business expenses, eventually recouping the entire amount he paid Seller for		

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cost to Buyer, so Seller pays no tax on these items.) **<u>Goodwill and section 197</u> intangibles (including: trademarks, patents, customer lists, etc.)-** the amount of the purchase allocated to goodwill and other Section 197 intangibles (minus the basis for these, if there is one) is treated as capital gain to Seller. **<u>Consulting Agreement</u>**- income from consulting agreements is treated as ordinary income to Seller. May be made between Seller-entity and Buyer or individual owner and Buyer. If between Seller-entity and Buyer, Seller-entity will have to report income and pay Seller-entity tax on income. The Seller-entity may also take advantage of any remaining loss carry-forwards. If Consulting Agreement is between individual owner and Buyer, individual owner treats consulting income as ordinary income. Owner must pay self-employment tax* on this income. The Owner must pay Social Security tax and Medicare tax, *both employer and employee portions,* since a self-employed individual is, in essence, both the employee and the employer. Owner may also write off business expenses against this income; has option to shelter a portion of this income in a pension plan. *Check with your accountant regarding current rules and limits for pension arrangements.*	merchandise and supplies. **<u>Goodwill and section 197</u> intangibles (including: trademarks, patents, customer lists, etc.)-** these items are treated as capital assets for Buyer. The amount of the purchase price allocated to these items may be amortized by Buyer over 15 years. **<u>Consulting Agreement-</u>** Buyer writes off payments made under Consulting Agreements as ordinary deductions. Buyer is NOT the employer, so Buyer does not have to pay any benefits or taxes on behalf of Seller.		

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**Check with your accountant for current self-employment tax rates.* Self-employment tax rates typically run about 12.4% for Social Security tax and 2.9% for Medicare tax (example of 2007 rates).			
Non-Compete Agreement- treated as ordinary income to Seller. Individual owner does NOT have to pay self-employment tax* on this income. Individual owner will still have to pay his portion of Social Security tax and Medicare tax (e.g., for 2007, this would be 6.2% for Social Security tax and 1.45% for Medicare tax) on this income; however, Seller cannot write off expenses or shelter pension plan monies using this income. **Check with your accountant for current Social Security and Medicare tax rates.*	**Non-Compete Agreement-** Buyer allocates a portion of the purchase price to a Non-Compete Agreement. This is amortized by Buyer over 15 years.		
Employment Contract- treated as ordinary income to the individual owner who has the Employment Contract. Owner is treated as an employee of Buyer, receives same benefits as any other employee. Individual owner not subject to self-employment tax on this income; must pay his portion of Social Security and Medicare taxes on income.	**Employment Contract-** Buyer hires individual owner to work as an employee for Buyer. Buyer writes off payments to individual owner as an ordinary deduction. Buyer also pays employer portion of Social Security and Medicare taxes on the payments made to individual owner; Buyer must provide owner with same benefits given to other employees.		
Loss Carry forwards and retained earnings- Seller maintains; may use if Seller continues in other lines of business.	**Loss Carry forwards and retained earnings -** Buyer cannot use Seller's loss carry forwards or retained earnings.	**Loss Carry forwards and retained earnings -** Buyer inherits Seller's books, including loss carry forwards and	**Loss Carry forwards and retained earnings -** Buyer inherits Seller's books, including loss carry forwards and

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		retained earnings on balance sheet, so Seller loses the ability to use these if he continues in other lines of business.	retained earnings on balance sheet.
Installment sale- Generally, Seller must pay taxes on installments in year they are received, however, Seller must pay taxes on depreciation recapture, inventory sales, and sales of publicly traded securities in the year of the sale regardless of when installment payments are actually received; deferred taxes on installment payments may be subject to interest. *Note: interest on deferred taxes is charged if the installment receivable exceeds 5M in year of the sale.* If Seller uses the installment receivable as collateral to obtain financing, the amount Seller is borrowing is treated as if it were a payment on the receivable, thus triggering tax consequences when received.	**Installment sale-** Buyer records these payments as they are made; they may be deducted as expenses, depreciated or amortized, depending on to what (i.e., inventory, equipment, goodwill, etc.) they were allocated.	**Installment sale-** Seller must pay taxes (capital gains) on installments in the year they are received; deferred taxes on installment payments may be subject to interest. *Note: interest on deferred taxes is charged if installment receivable exceeds 5M in year of the sale.*	**Installment sale-** Buyer records these payments as they are made. These are added to Buyer's cost basis in the company stock.
Seller-entity is a C Corporation- If the Seller-entity is a C corporation, there is double taxation; first tax is paid by the corporation on any profit/gain from the sale, then tax is paid personally by the shareholders if they receive dividends. If the Company is liquidated after the asset sale, shareholders are taxed at the liquidation rate (typically about 15% - 20%). *Check with your accountant for the current liquidation tax rate.* If shareholders are paid salaries or		**Seller-entity is a C corporation-** If the Seller-entity is a C-corporation (or an S-corporation), shareholders report gain/loss on their tax returns and pay taxes, as appropriate.	

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bonuses from the Company, such amounts will be deductible by the C-corporation as expenses, but will be subject to employee-related taxes and the employer matching contributions.			
Employees with Employee Contracts- Seller determines whether to include these as part of the sale. If they are not included in the sale, Seller will remain liable for satisfaction of its obligations under such contracts after the sale, unless such employees voluntarily terminate their employment with Seller to go to work for Buyer (or elsewhere).	**Employees with Employee Contracts**- Buyer can decide whether or not to assume these.	**Employees with Employee Contracts**- Contracts with the Seller-entity, remain with the entity. Consequently, Buyer automatically assumes them by purchasing the stock; Seller is relieved of all responsibility, unless Seller personally guaranteed any of the obligations.	**Employees with Employee Contracts-** Buyer automatically assumes these contracts by virtue of becoming the owner of the Seller-entity. *Note: if the contracts do not contain provisions allowing for automatic assumption by Buyer, then the obligations of the employees may not be enforceable by Buyer, unless the employees approve the transfer.*
Other Employee Benefits- Seller usually does not include these in an asset sale.	**Other Employee Benefits**- Buyer decides whether or not to offer and administer the same benefits; not required to do so.	**Other Employee Benefits**- Included in the sale; liabilities and responsibility for administration are transferred to Buyer.	**Other Employee Benefits**- Buyer assumes responsibility and liabilities associated with employee benefits; Buyer may choose to terminate plans but is still responsible for any associated liabilities. *Note: if Buyer assumes any of the existing benefit plans, he should maintain separate accounts from any existing benefit plans Buyer already maintains.*
Worker's Compensation insurance- Not included in the sale.	**Worker's Compensation insurance-** Buyer must negotiate his own WC insurance if Buyer elects or is required to carry it.	**Worker's Compensation insurance-** Insurance, liability, and incident records are transferred to Buyer.	**Worker's Compensation insurance**- Insurance, liability and incident records are assumed by Buyer.
		IRC Section 338 (g) Election (Stock Sale Treated as Stock Sale by Seller) - If Buyer makes Section 338(g) election, Seller treats the sale	**IRC Section 338 (g) Election (Stock Sale Treated as an Asset Sale by Buyer) -** If Buyer makes Section 338(g) election, Seller treats the sale

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		as a regular stock sale and individual shareholders pay capital gains on gain from selling the stock in the Company. Seller-entity must pay taxes on the gain from the sale of its assets and use tax. Buyer pays this on behalf of the Seller-entity, as the Buyer now owns the Seller-entity. *Note: Seller-entity can use any NOL carry of offset gain realized in the asset sale. Seller loses any unused NOL carry after the transaction is closed.*	as a regular stock sale (individual shareholders pay capital gains tax on sale of their stock), while Buyer treats the sale as an asset sale. Buyer gets stepped up basis in assets and writes off the purchase price as he would in an asset sale. ***Buyer also pays any gains the Seller-entity realizes as if it were an asset sale as well as any use tax.*** Buyer will make a 338(g) election to obtain the stock in the Seller-entity, while also getting a stepped us basis in the assets; Buyer assumes corporate entity and liabilities, while Seller gets the benefit of a stock sale and release from all unguaranteed liabilities. *Note: Buyer does not maintain any of Seller's tax attributes (e.g., no NOL carry, no earnings or profits.) For all other non-tax purposes, Buyer becomes same Company as Seller (e.g., same FEIN.)*
		IRS Section 338(h)(10) Election for an S Corporation- (Stock Sale Treated as Asset Sale by Buyer and Seller)- If Seller is an S corporation, Seller and Buyer may make a 338(h)(10) election to treat the stock sale as an asset sale. Seller, individually, pays taxes on the sale of the assets as if it were a regular asset sale. Seller does NOT pay any gains on the sale of his stock in the Company. Seller pays regular tax rates on the	**IRS Section 338(h)(10) Election for an S Corporation- (Stock Sale Treated as Asset Sale by Buyer and Seller)-** If Seller is an S corporation, Seller and Buyer may make a 338(h)(10) election to treat the stock sale as an asset sale. Buyer treats the sale as an asset sale. Buyer gets stepped up basis in assets and writes off the purchase price as he would in an asset sale. Buyer assumes corporate entity and liabilities.

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SELLER	***BUYER***	***SELLER***	***BUYER***
		asset sale as appropriate (e.g., depreciation recapture, LT gains tax rate on intangibles, etc.). *Note #1: Typically the 338(h)(10) election results in Buyer paying a higher price to Seller for the Company, since Seller will have to pay taxes on the gain in the assets, even though it is a stock sale. Buyer is usually willing to do this because of the benefit of getting the stepped up basis in the assets.* *Note #2: Seller loses any unused NOL carry after the transaction is closed.* *Note #3: If Seller is an S corporation which was originally a C, but made an S election within <u>the last 10 years</u>, Seller will have to pay a 35% corporate built in gains tax on any gain (realized up to the date of the S election) from ALL assets sold.*	*Note #1: Typically the 338(h)(10) election results in Buyer paying a higher price to Seller for the Company, since Seller will have to pay taxes on the gain in the assets, even though it is a stock sale. Buyer is usually willing to do this because of the benefit of getting the stepped up basis in the assets.* *Note #2: Buyer does not maintain any of Seller's tax attributes (e.g., no NOL carry, no earnings or profits.) For all other non-tax purposes, Buyer becomes same Company as Seller (e.g., same FEIN.)*