allBusiness
YOUR SMALL BUSINESS ADVANTAGE

Selling Your Business: Entity Sale vs. Asset Sale

When selling a business you have two options: You can opt either for an "entity sale" or an "asset sale." Making the right choice between the two can help minimize the taxes that you will owe once the sale is complete.

In an entity sale, you sell either your shares of corporate stock or your membership interests in an LLC. The business's assets — equipment, furniture, real estate, inventory, accounts receivables, etc. — continue to be owned by the entity, and the entity owned by the buyer. In an asset sale, your corporation or LLC sells its assets to the buyer and you continue to own the corporate stock or LLC membership interests. In this system, you still own the entity — although it could end up being worthless.

The legal distinction between an asset sale and an entity sale is important, because it dictates how you will be taxed and how the buyer will write off the purchase on his or her tax return. Asset sales typically permit buyers to receive depreciation benefits sooner than they would with an entity. On the other hand, as a seller you'll likely come out better from a tax standpoint by selling the entity, because you'll be taxed at the low long-term capital gain rate.

In an asset sale, your part of the tax bill may be composed at the ordinary, higher income rate. Sellers should be especially wary about using an asset sale for a C corporation, because with them there is risk of double taxation. This discrepancy is often resolved in a compromise between the buyer and seller and is reflected in an adjustment of the selling price or payment terms. If negotiations result in you agreeing to an asset sale, be firm about getting a high price, because you'll face appreciably higher taxes and liability risks.

If you do agree to an asset sale, give careful thought to which assets you'll sell off with the company. As you prepare for the sale, remove unproductive or nonessential assets from the business. The buyer isn't likely to pay extra for them, and you may be better off selling these assets yourself. Valuable assets such as real estate or equipment, and patents, trademarks, or copyrights that you may want to retain and license back to the buyer can all become an important negotiation point. By retaining some number of the assets, you can lower the purchase price and make the business affordable to more buyers. Also, by retaining real estate from the business you can hold on to rental income for the future and keep open the option of selling it to the buyer — or someone else — later.

In the case of a sole proprietorship, you can simply retain ownership of those assets that you want to keep; you won't be taxed on any profits unless and until you sell them. In the case of partnerships and LLCs, the unwanted assets can be distributed to partners or members upon liquidation, though the dissolution of the business may mean that individual partners will have to pay some taxes. And if you're a corporation and want to remove assets from the business entity, you may have to purchase them at fair market value, with the corporation paying tax on any capital gains.

Sellers prefer entity sales over asset sales, because with them any of the company's unknown liabilities are transferred to the new owner; whereas in an asset sale the liabilities remain with the seller. These liabilities might include contract claims, potential product liability claims, or employee lawsuits resulting from the seller's ownership of the company.

These general rules can be altered in the sales contract, but doing so requires careful legal drafting by an attorney. In an asset sale, for instance, the contract can require the buyer to assume certain of the seller's liabilities. In consideration of the fact that third parties will not be bound by the contract's terms, the contract may also incorporate escrow arrangements or indemnification clauses that will eliminate some of the buyer's risks. If an important element is left out, general rules will apply.

For more on the tax consequences inherent in business sales, read Tax Concerns When Selling Your Business. Be sure to also check out What To Look For When Buying a Business for additional information on this topic.

☐ Close Window

;