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FARALLON LAW GROUP NEWSLETTER

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Structuring the Sale or Purchase of a Business

Selling or buying a business can be complex and present a number of structuring options. If you are a sole proprietor or a general partnership, then selling a business requires you to sell the business' assets. If your business is in an entity, such as a corporation or limited liability company, then you have several options.

There are three primary structures to sell a company: sale of the assets, sale of the ownership interests or merger of the company into another company.

- **Asset Sale** In an asset sale, it is critical to be clear exactly which assets are included and which are not. The sale may also include the assumption of liabilities (such as current contracts) which should be expressly considered and negotiated.

- **Stock Sale** In a stock sale, the ownership interests (corporate stock, LLC membership interests or otherwise) are sold by the owners. The buyer then owns 100% of the company which holds the business. If the buyer is an entity, it owns the business as a subsidiary. All assets and liabilities (known or unknown) remain with the company which is owned by the buyer.

- **Merger** When a company is merged into another company, only one company survives but with the combined assets and liabilities of both companies. The owners of the selling company convert their ownership interests in the selling company into ownership interests in the acquiring company.

Some of the key factors determining which structure is chosen are liability exposure, third party approvals and tax efficiencies.

- **Liabilities** In stock sales or mergers, all assets and liabilities automatically remain in the entity being sold. On the other hand, only the specified assets and liabilities are transferred in as asset sale. Thus, an asset sale is often used if the buyer is concerned about known or unknown liabilities which could "follow" the business. An asset deal would also be preferred if the "liability shield" protecting the owners of a selling entity may be compromised, i.e., if the owners didn't follow corporate formalities such that creditors could try to impose the business' obligations on the owners themselves. But keep in mind that even in an asset sale, creditors of the selling company may be able to follow the assets and impose liability on the buyer under a "successor liability" theory.

- **Third Party Consents** In an asset sale, all agreements that will be transferred must be examined to determine whether the consent of the third party will be required to assign the agreement to the buyer. On the other hand, in stock sale and mergers the agreements are not being assigned. However, some third party consents may nevertheless be needed for any "change of control" (i.e., where a change of ownership results in another party obtaining control of the selling company). An asset sale may require obtaining third party consents which can be frustrating and may result in delays.

- **Taxes** Often, the structuring of the sale or purchase of a business is primarily driven by tax considerations and efficiencies. Buyers will generally prefer an asset sale for tax reasons. However, complex stock sale or merger structures are often used such as a reverse triangular merger (where a newly formed subsidiary of a public buyer merges into the selling company and the owners of the selling company would receive shares in the public buyer). We suggest you contact your tax advisor (tax counsel or a qualified CPA) early in the process to minimize having to determine the most tax-efficient structure for your deal.

Please feel free to contact Boris Lieberman or Mario Kashou at 415-255-2450 if you have questions about selling or buying a company.