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Asset Transactions vs. Stock Transactions

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Asset transactions and stock transactions are the two most common types of transaction structures when purchasing or selling a business. Asset transactions occur when buyers assume specific liabilities and purchase specific assets from a business, while stock transactions occur when buyers purchase shares of stock from the company that they wish to acquire.

By specifically identifying assets and liabilities to be purchased and assumed in an asset transaction, buyers are able to avoid undesirable assets and liabilities. Additionally, in an asset transaction, the cash and long-term debt obligations of an entity are usually not acquired by the buyer. The purchased assets and liabilities would either be used in the formation of a new entity or would be rolled into the buyer's existing company. The seller would remain as the legal owner of the target entity with any remaining assets and liabilities.

Stock transactions are much simpler in concept, which is one of the main reasons that they are more commonly used. Unlike an asset transaction, stock transactions are less complex and are easier to execute because the buyer does not have to deal with costly revaluations of assets and liabilities due to the fact that they are all assumed at the time of purchase.

However, a major tax advantage of an asset transaction is that the buyer will receive a step-up in basis in the purchased assets equal to the purchase price. The step-up in basis allows for additional future depreciation and/or amortization expense, which in turn, will reduce future taxable income and income tax expense. In a stock transaction, the buyer does not receive a step-up in basis, and all assets and liabilities transfer at their existing tax basis.

Furthermore, the goodwill acquired by the buyer in an asset transaction can be amortized on a straight-line basis over 15 years under IRC Section 197. Goodwill is not tax-deductible in a stock transaction until the stock is later sold.

The seller, however, can be at a tax disadvantage with an asset transaction because the gains on certain assets would be treated as ordinary gains and taxed at higher rates. The tax advantage for the seller lies in a stock transaction because the sale of equity interests would be taxed at capital gains rates, which can be significantly lower than ordinary income rates. For this reason, the seller may insist on a higher purchase price if the transaction is structured as an asset transaction.

There are many factors to consider when choosing the appropriate form of transaction structure. Each option will have significant tax consequences for both parties.

Therefore, it is important for both the buyer and seller to consider the benefits and consequences of each type of transaction to determine which structure best suits their needs.

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