Share purchase or asset purchase: What is the difference?

A buyer can acquire a business in two ways: a share purchase or an asset purchase. While both structures can broadly achieve the same commercial objective, there are advantages and disadvantages to each, together with fundamental differences in legal effect and tax treatment.

Generally speaking:

- An asset purchase involves the buyer acquiring select assets and rights and sometimes assuming responsibility for certain liabilities relating to the target business; and

- A share purchase involves the buyer acquiring the shares in the company (normally the entire issued share capital) from the company's shareholders.

What is an asset purchase?

In an asset purchase transaction, the buyer takes over the target's business by purchasing a collection of specified assets and rights and sometimes assuming responsibility for certain liabilities which comprise the target business. The types of assets (both tangible and intangible) that a buyer commonly purchases include, for example, but are not limited to, the business premises, lease of the premise (if leased), the benefit of business contracts, intellectual property rights (signage and telephone numbers etc.), plant and machinery, goodwill and stock.

The buyer and seller will negotiate precisely which assets the buyer will acquire from the business upon completion. The assets not agreed to be purchased by the buyer under the asset purchase agreement will remain with the seller.

What is a share purchase?

A share purchase involves purchasing the shares of the company from the shareholders. A limited company has its own 'legal personality', separate from its owners. Therefore, the company as an entity owns its business, assets, obligations, liabilities and rights independently. A buyer purchasing the shares of a company acquires everything owned by that company (including the liabilities). The only assets which change hands are the shares.

The principal document involved in the sale of shares is a share purchase agreement, which will set out the terms upon which the buyer shall purchase the shares. Share purchase agreements can often be quite lengthy based on the complexity of the business and if the consideration being paid for the business is particularly high or paid over a deferred period of time. The reason is that selling the shares means the buyer becomes the company's owner. All liabilities are also theirs to deal with.

What's the difference?

The most significant difference between a share purchase and an asset purchase is that in an asset purchase, the buyer has the ability to control and pick which assets are being purchased, allowing the buyer to choose only the best assets and leave behind any liabilities. In contrast, when buying the shares of a company, the company's separate legal personality means that the buyer has no control over what is obtained and will need to carry out legal due diligence to ascertain all the assets and liabilities.

The flexibility of an asset deal means that buyers and sellers often favour this structure, especially where a business has significant liabilities that can be left behind. However, there are some other key advantages/disadvantages you should consider.

The main differences between an asset sale and a share sale.

- Control over what's transferred.

  In an asset purchase, the parties can control what is being transferred, meaning the buyer can pick the assets or liabilities it wants to acquire. In a share purchase, the buyer does not have this luxury as the company owns all the assets.

- Shareholder involvement – who are the sellers?

  In a share purchase, a buyer usually wants to acquire the entire issued share capital of the target company and must obtain approval from each selling shareholder. If any of the shareholders are untraceable or unwilling to participate in the transaction, the deal is unlikely to proceed. In an asset sale, the company that owns the assets will conclude the sale (subject to director approval), and the individual shareholders are not required (unless there is a shareholders' agreement).

- Structural complexity.

  A share purchase can be the simpler option as the only asset transferring is the target company's share capital. Therefore, in a share purchase:

  - It's not necessary to identify each asset, right or liability of the target business.
  - There's no need to deal with the specific transfer formalities for different categories of assets and rights (for example, obtaining third-party consent to a change of control or novating contracts).
  - The target company's contractual and licensing arrangements are largely undisturbed by the sale.
  - In an asset sale, the seller is the company acting by its directors.

- Due Diligence.

  Due diligence is the information-gathering process carried out by a prospective buyer to find out as much information as possible about the target company early in the transaction negotiations. The purpose of due diligence is for the buyer to investigate the assets, liabilities, trading performance and finances of the target company. Through this process, the buyer should aim to gain a complete picture of the target company and its critical success factors, strengths and weaknesses. The due diligence process is far longer and more intrusive in a share purchase, as the buyer will inherit all the company's liabilities (past and present)

  There are commonly three types of due diligence:

  1. Commercial - this is carried out by the buyer to decide whether or not to acquire the target company.

2. Financial - the buyer's accountants should then carry out a financial investigation into the target company to ensure that the proposed price is accurate and reflects its true value.

3. Legal - after the buyer is satisfied with the first two points, then the buyer's solicitors will raise various questions of the seller's solicitors.

Legal due diligence will often involve a lengthy questionnaire from the buyer's solicitor requesting information from the seller. The focus of legal due diligence will depend on the nature of the company being acquired. For example, if the target company is a property company, the main priority will be to fully investigate the title on its key properties. For a software company, the focus will often be on intellectual property rights. The buyer's solicitor will usually then prepare a legal due diligence report for the buyer, highlighting any potential legal issues.

Due diligence is an essential preliminary to ensure contractual protection and can help identify the level and areas of protection needed as well as any risks that the buyer should avoid completely. At any point during the due diligence process, something could be uncovered, the nature of which means that the buyer decides not to proceed with the purchase, seeks a reduction in the price, or at the very least, that some specific protection is sought in the main agreement.

The purpose of due diligence is to either provide the buyer with the comfort that the target company is clean and issue-free or, to the extent that there are issues, that the buyer knows about these and the relevant protections can be built into the agreement, or a price reduction is sought. Effectively, the due diligence process helps the buyer decide whether to proceed with the acquisition and, if so, at what price and on what terms.

- Employees.

In an asset sale, you must adhere to the application of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE)

TUPE applies to asset purchases but does not apply to share purchases. Where TUPE applies, the employment rights of the employees of the target's business are protected, and obligations are imposed on the buyer and the seller. Dismissals that are made because of a TUPE transfer are likely to be automatically unfair, and there are financial sanctions available to employees if the buyer and/or the seller fails to comply with their TUPE obligations.

Conversely, in a share purchase, the employees remain contracted with the company, and therefore there is no transfer of employment rights or TUPE to deal with. The buyer can then proceed with redundancies and staff restructuring as the owner of the company.

- Tax implications.

In an asset purchase, the selling company is taxed on the consideration paid by the buyer. In order for the shareholders to subsequently extract the proceeds of sale from the company, it is necessary to pay a dividend or make some other form of distribution to its shareholders (which may incur a further tax liability).

By contrast, on a share purchase, the proceeds of the sale are paid directly to the company's shareholders, which may result in a lower tax liability. For example, the seller may be eligible for entrepreneur's relief. In essence, it allows the seller to apply a reduced rate of 10% capital gains tax on the profits the seller shall make when selling qualifying assets (such as the business). Every seller can claim up to £1 million of entrepreneurs' relief in their lifetime, and they can claim as many times as they'd like, provided the claims are within this £1 million limit.

An individual seller of assets or shares will likely be subject to capital gains tax, while a company selling assets will be subject to corporation tax. You should take specific tax advice from your accountant before deciding which method to pursue, as the tax liability differs significantly.

- Warranties and Protections.

  In agreeing to acquire a company, a buyer will have usually relied on various statements and assumptions originating with the seller. To compensate for the lack of statutory protection available to a buyer and to ensure the buyer can recover its loss if the basis of its decision to proceed with the purchase subsequently proves to have been incorrect, the main statements and assumptions being relied on are known as warranties.

  Far more warranties are sought in share purchases due to the fact that the buyer will inherit all of the company's liabilities, whether they're known or otherwise. In an asset purchase, the buyer will seek specific warranties in consideration of what assets are being acquired.

  The number of warranties and the matters covered will vary considerably depending on the nature of the business carried on by the company, the extent of the company's assets and the identity of the person providing the warranties. The most common areas covered by warranties are, but not limited to:

    - Capacity/authority to sell;
    - Ownership of shares;
    - Group structure;
    - Accounts;
    - Contracts;
    - Licences/consents;
    - Litigation;
    - Title to assets;
    - Intellectual property rights;
    - Employment matters; and
    - Taxation matters.

  Warranties given in these areas relate to matters in the past or present but will not normally relate to the future performance of the company.

  If a warranty turns out to be incorrect, the buyer can bring a claim against the seller or warrantor for contractual damages. The buyer will need to show both a breach of the warranty (i.e. that it is untrue) and that it has suffered a loss as a result of the breach in order to bring a successful claim. The buyer's claim will be for such damages as are sufficient to put it in the position it would have been if the relevant warranty had been true. The buyer has a duty to mitigate its loss. Where a specific liability is identified, the buyer will likely seek to include an indemnity rather than a warranty. Indemnities provide a guaranteed remedy to the buyer in circumstances where a breach of warranty may not necessarily give rise to a claim for damages.

- Separation at the end.

  In an asset purchase, at the end of the transaction, the seller would be left with the remaining assets, obligations and liabilities and would need to either continue trading (subject to the terms of the agreement) or wind down the remaining assets, obligations and liabilities. The seller would also need to consider 'running off' their existing personal indemnity insurance (if any) to honour claims made after the business has ceased trading.

  In a share purchase, it’s the seller’s aim to have a clean separation from the company and its future trading upon completion. However, the seller will remain liable under the warranties, during which time the buyer could make a claim against the seller. It is, therefore, in the seller's interest to limit the warranties given and the period of liability.

Conclusion.

To assist in your decision-making, we have prepared a non-exhaustive list to illustrate some advantages and disadvantages of an asset purchase compared to a share purchase:

Advantages of an asset sale and purchase	Advantages of a share sale and purchase
Negotiating power The buyer can decide what if any, assets or liabilities it is going to assume in the transaction. This limits the buyer's exposure to liabilities that are large, unknown, or not stated by the seller. The transaction is also unlikely to require shareholder consent or other shareholder involvement.	**Entrepreneurs' relief** If the shares are sold for more than the seller paid for them, there is likely to be a chargeable gain. If the company is a trading company (or holding company of a trading group), the seller may benefit from capital gains tax (CGT).
Quicker sale As there is less due diligence for the buyer to perform in an asset sale (due to cherry-picking what assets and liabilities it wants to acquire), the transaction can often be completed more quickly.	**No double tax charge** There is a potential double tax charge on an asset sale which may result in the seller being taxed twice, once on the gain made from the sale of the assets and again when the sale proceeds are distributed. By contrast, on a share purchase, the proceeds of the sale are paid directly to the company's shareholders, which may result in a lower tax liability.
Allowable losses If the capital assets (other than those on which capital allowances have been claimed) are to be sold at a loss, this could result in an allowable loss that can be set against other chargeable gains of the seller.	**Roll-over relief** A share sale may enable the seller to defer tax on chargeable gains. This is not always possible in an asset sale.

Balancing allowance A sale of assets, which have fallen in value more rapidly than their tax depreciation, may give rise to capital allowances that would not arise on a share sale. The seller is treated for tax purposes as making a trading loss equal to the difference between the sale price of the asset and its tax written-down value. That loss can be set against other income or chargeable gains to reduce the seller's taxable profits.	**No capital allowances balancing charges** A single chargeable gain will arise on a share sale. On an asset sale, the sale of each category of the asset will have different tax consequences, which will need to be considered and apportioned carefully.
Retained assets The seller can choose which assets to sell and which to keep. If there is a share sale, if so desired to keep certain assets, these may have to be transferred out of the company prior to the sale of the business. This may lead to additional costs and tax charges.	**Continuity** A share sale does not affect the continuity of the business, which carries on without interruption. With an asset sale, it may not be possible to transfer some assets or agreements without the consent of a third party.
	Peace of Mind Some contracts may have prohibitions against assignment. This means that it may be easier to sell the shares than re-assign or novate a large number of contracts or licences. The impact of the General Data Protection Regulations (GDPR) will also be limited in a share purchase, as the customers' data would not need to be transferred.
Disadvantages of an asset sale and purchase	**Disadvantages of a share sale and purchase**
Third-Party Approval Third-party approval of the transaction is sometimes required, and this can often prove problematic and delay or even completely destroy the deal – for example, obtaining landlord approval to assign a lease.	**Longer sale** Share sales typically take a lot longer to complete than asset sales. Further, the buyer will almost always insist on various protections and will want the seller to provide warranties, guarantees and indemnities to limit the buyer’s risk. The negotiating of these terms can also drag out the transaction.
Tax calculation The tax calculation can be quite complex as different categories of assets may have to be treated differently for tax purposes.	**Greater risk** Buying shares is a lot riskier for the buyer as he's taking on all the business liabilities, which may not be fully apparent till a year or two down the line.

<u>Potential loss of customers/suppliers</u> Customers and suppliers who are signed up for automated payments, online payments or recurring payments will need to be transferred to the buyer upon completion. Some may not follow you.	**<u>Employee's existing terms</u>** While TUPE (Transfer of Undertakings, Protection of Employees Act) doesn't apply to share sales, the buyer is effectively taking on all the employees and is responsible for honouring the contracts under which they were employed.
<u>TUPE</u> Buying the assets of a business will trigger the TUPE Transfer of Undertakings (Protection of Employment) Regulations 2006. The buyer will be responsible for taking on all the employees of the business on the same terms they enjoyed before.	**<u>Greater need for due diligence</u>** Given that the buyer will be inheriting all the assets and liabilities of the company, the due diligence process is far greater and more intrusive in a share purchase. This often increases the length of negotiations and involvement from both parties.
<u>Personal Indemnity Insurance</u> The seller would need to 'run off' their existing personal indemnity insurance or obtain run-off cover to honour claims made after a business has ceased to trade.	

The above are just some factors that should be considered when deciding upon a share purchase or asset purchase.

If you are buying or selling a business, it is important to involve advisors early (including solicitors and accountants) to ensure that careful consideration is given to all the circumstances and that the correct purchase/sale structure is chosen.