Tax Implications of Selling Your Business

When it comes to selling your business, it can be easy to only focus on the sale price. However, the way in which the sale is structured may impact the after-tax proceeds that you personally retain. Depending on whether you are selling the shares of your corporation or the company is disposing of its assets, the after-tax value can differ significantly even if the sale price is the same.

Sale of shares

When it comes to the sale of your shares, the purchaser would acquire the shares of the company and you would receive the proceeds personally. For income tax purposes, you will be subject to tax on the capital gain realized as part of the transaction, which is the difference between the proceeds received and the adjusted cost base of your shares.

The ability to potentially use your lifetime capital gains exemption (LCGE) makes this type of transaction particularly attractive. Provided certain criteria are met, you may be able to shelter up to the first $866,912 of capital gains resulting on the sale of your shares from personal income tax. (The $866,912 amount of the exemption is the 2019 limit and is indexed to inflation).

A thorough review of your situation by an accountant will help to determine if the shares you are selling meet the LCGE requirements or whether you need to take certain steps within the business in order to claim the exemption.

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Another benefit of selling the shares of the business is the potential to defer taxes. If all, or a portion, of the proceeds that you receive are in the form of a note receivable, the tax rules may allow you to defer the taxation on parts of the capital gain.

Sale of assets

The sale of assets involves your company selling all, or various, assets of the business, including goodwill, to the purchaser.

Since the company is the entity selling the assets, there will be corporate tax to pay on the transaction. The allocation of the purchase price to the various assets being sold can impact the amount of tax paid, as capital assets and goodwill are tax preference items (i.e., subject to tax at more favourable capital gains rates).

After the company has paid its taxes, the funds are “trapped” in the corporation that you still own. There may be a second incidence of tax when the after-corporate-tax proceeds are extracted and distributed to you as a dividend. However, this personal tax liability can be deferred provided that proceeds are not needed immediately and funds can remain in the company (and potentially be invested by the company) to be withdrawn at a future date when a taxable event may occur.

In the situation of a tiered ownership structure (i.e., you own shares of a holding company which in turn owns the shares of the operating company) where the holding company is selling the shares of the operating business, the sale will be considered a “sale of assets” transaction because the proceeds will be paid to the holding company and the capital gains exemption cannot be claimed on the sale.

Plan ahead

Understanding the tax implications prior to any sale process can help to achieve the best outcome. While there are many non-tax factors that will influence the decision of whether to sell shares or assets, the tax implications may be an important motivator. In many circumstances, the combined corporate and personal tax liabilities in an asset sale may be significantly higher relative to a share sale, which may be a reason to negotiate a higher sale price.

Contact your Canaccord Genuity Wealth Management Investment Advisor to learn more about how a sound financial plan can help when it comes to selling your business.

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