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Purchase and Sale of Shares

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PURCHASE AND SALE OF SHARES

INTRODUCTION

This paper highlights some of the common income tax considerations that arise on share purchase transactions and, in particular, focuses on items that are of particular importance for non-tax practitioners to understand. This paper will begin with a discussion of general income tax considerations in share purchase transactions and will then discuss specific income tax considerations in non-arm's length share purchase transactions.

ASSET SALE VS SHARE SALE

In many sale transactions, there is frequently negotiation with respect to whether the assets of a corporation or its shares will be acquired. While there are a number of factors that will impact whether shares or assets are sold, from an income tax perspective a vendor who wishes to receive cash personally at the end of the transaction will generally prefer to sell shares, particularly if such shares are eligible for the lifetime capital gains deduction. A purchaser, on the other hand, will generally prefer to acquire assets. For the vendor, this is due to the fact that the effective tax rate on capital gains is only 24%, whereas the tax rate on dividends (depending on whether the cash can be extracted as an eligible or ineligible dividend) is between 31.71% and 42.30%.[1] A portion of the cash may also be able to be extracted as a tax-free capital dividend. As the vendor would generally need to extract cash from the corporation in the form of dividends on an asset sale and the corporation would need to pay tax on any gains it realized, this generally results in a higher amount of tax payable on the transaction. Further, as the result of recent changes to the *Income Tax Act,*[2] if a corporation realizes a capital gain on the disposition of its assets and would otherwise be subject to refundable tax on the taxable portion of this capital gain, the corporation would not receive a refund of its refundable tax unless an ineligible dividend was declared.

The purchaser, on the other hand, prefers assets because the purchaser will generally not acquire the liabilities of the target corporation (including tax liabilities)[3] on an asset sale and, most importantly from a tax perspective, will acquire the assets at a cost equal to the amount paid for the assets. As a result, if the purchaser were to acquire shares of a target corporation that had significant gains on the assets, they would generally be left with an inherent income tax liability when the target corporation ultimately disposed of those assets. This inherent tax liability is often a significant negotiation point when discussing the purchase price on a share purchase transaction.

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[1] Based on top marginal rates applicable in Alberta as of July 31, 2019.

[2] R.S.C. 1985 c. 1 (5th Supp.) (the "Act"). All statutory references in this paper are to the Act unless otherwise stated.

[3] There are some liabilities that attach to the assets, particularly in a sale of all the assets of the corporation, such as certain provincial sales tax liabilities.