IG PRIVATE COMPANY ADVISORY

Tax implications of selling your business

Selling a business can have significant tax implications for both the seller and the buyer. Business owners must understand these tax consequences and strategically plan to minimize the tax burden. Below, we provide an overview of the tax implications of selling a business and offer insights into how to prepare for them.*

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Asset vs. share sale

The way the sale is structured can significantly impact your tax liability. The two common scenarios are asset sales and share sales.

Asset sale: In an asset sale, the buyer purchases specific assets and assumes specific liabilities of the business. The seller is taxed on the capital gains and recaptured capital cost allowance that may result from each asset sold, the tax treatment varies based on the type of asset. Capital property such as land will trigger capital gains or losses, depreciable property such as equipment may result in recaptured capital cost allowance, whereas the sale of intangible assets like goodwill may trigger both a capital gain and recaptured capital cost allowance.

Share sale: In a share sale, the buyer purchases the shares of the company and the seller realizes a capital gain equal to the difference between the sale price and the adjusted cost base of the shares. However only one half of the capital gain is taxable. For example, if you sold the shares of your business for $15,000,000 and your adjusted cost base in the shares was $5,000,000, your capital gain would be $10,000,000, but the taxable portion of the capital gain would be only $5,000,000.

The scenario which will provide the best tax result for the seller and purchaser is very fact-dependent, but generally speaking, sellers prefer to sell shares and prospective purchasers prefer to acquire assets. From the sellers' perspective, a share sale will typically generate capital gains which are tax-preferred, and from the purchasers' perspective an asset sale can avoid acquiring unwanted liabilities and allow for enhanced future capital cost allowance deductions.

*Please speak with your tax advisor for tax advice specific to your circumstances.

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Minimizing tax on a share sale

Capital gains deduction: Shareholders of Canadian-controlled private corporations may be able to claim the lifetime capital gains exemption if the shares sold meet the definition of qualifying small business corporation shares. As of 2024, the exemption limit was up to $1,016,836. For a shareholder in a 50% tax bracket, this translates into potential tax savings of over $254,000 when the gain on private company shares equals or exceeds their available exemption limit. Planning is often necessary years in advance of a sale in order for the shares to qualify for the exemption.

Estate freeze: This strategy limits the capital gain attributable to an owner's shares in the business by passing future growth to a spouse or the next generation, thereby limiting the tax liability for the owner-manager. In an estate freeze, you typically exchange your common shares for preferred shares, freezing their value at their current value. Then, new common shares are issued to your successors, or to a family trust, allowing them to benefit from future growth. This strategy can be complex and requires professional guidance to implement properly.

Other considerations

Negotiate the allocation of purchase price: In an asset sale, the buyer and seller can negotiate the allocation of the purchase price among the various assets. This can help minimize taxes for both parties. For instance, where appropriate, allocating more to assets that can be depreciated (like equipment or software) could provide the buyer with future tax deductions, while the seller may benefit from a lower tax rate if the recapture is active business income.

Capital gains reserve: If the proceeds from the sale of shares or other capital assets are payable over time, a reserve can be claimed to defer recognition of a portion of the capital gain realized, generally spreading the taxation of the gain over a period of up to 5 years.

Use RRSP contribution room or establish an Individual Pension Plan: Contributions to a RRSP can create deductions that will help shield the sale proceeds from tax. Establishing an Individual Pension Plan prior to sale can create even larger deductions and tax savings. For a share sale, these large deductions for IPP past service contributions can help purify the corporation of passive assets that may be preventing use of a shareholder's lifetime capital gains exemption. Alternatively, these corporate tax deductions can be used to offset corporate income resulting from an asset sale.

Provincial and territorial taxes: In addition to federal taxes, you may also have to pay provincial or territorial taxes when selling your business. The rates and rules vary by jurisdiction, so it's crucial to consult with a tax professional familiar with your local tax laws.

Seek professional advice

Given the complexity of the tax implications associated with selling a business, it's crucial to consult with a tax professional. They can help you navigate the tax issues, plan for the sale, and identify strategies to minimize your tax liability.

Understanding and planning for the tax implications of selling your business is an essential part of the sale process. By being aware of the potential tax consequences and seeking professional advice, you can strategically minimize your tax burden and maximize the proceeds from the sale. Starting your planning years in advance of a sale can frequently create more tax saving opportunities.

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David is Senior Vice President, Head of IG Private Company Advisory, where he leads the team that provides mid-market business clients with strategic advice and services related to business financing, growth and succession. He brings over 27 years' experience in investment banking and capital markets. Before joining IG in 2023, David led the private company advisory business at a leading Canadian financial institution.

David is a Chartered Financial Analyst and has a Master of Business Administration degree from the Richard Ivey School of Business at Western University. Additionally, he teaches mergers, acquisitions and business strategy part time at the Ivey Business School. David is based out of London, Ontario.

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