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Tax Implications of Selling a Business

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For many entrepreneurs, their business is their biggest asset. When it comes time to sell, the way you structure the sale – and the tax planning you do in advance – can have a substantial impact on what you keep after tax. This article discusses the main tax issues to consider when selling your business. The details discussed throughout the article can significantly influence the overall tax burden of this monumental transaction, so it is critical that you obtain tax advice in advance to begin the complex planning process that must be tailored to your unique circumstances.

Asset Sale vs. Share Sale

One of the biggest determinants in the tax impacts of selling a business is whether the buyer will acquire:

- the shares of your corporation; or
- the assets used in the business.

Share Sale

When you sell shares of your corporation, you are selling your ownership interest in the company. The buyer "steps into your shoes" – they acquire the corporation with all its assets and liabilities (e.g., debts and potential tax reassessments).

For the seller, a share sale generally:

- triggers a capital gain or loss – only a portion of capital gains are included in income; and
- may allow use of the Lifetime Capital Gains Exemption ("LCGE") (the maximum deduction for 2026 is 50% of $1,275,000 ($637,500)) if the shares are "qualified small business corporation shares" ("QSBC shares").

Consequently, a share sale is typically the sale structure that sellers prefer because it is more advantageous from a tax perspective compared to an asset sale (which is not eligible for the capital gains exemption). Sellers can benefit from the capital gains exemption, which may shelter their capital gains completely from tax. And any capital gains that are not eligible for the exemption benefit from lower taxation (compared to regular income, for example) due to only half of the capital gain being included in income.

If your business is structured as a sole proprietorship, you can roll your business assets into a corporation in contemplation of the share sale. Planning in advance of the transaction is highly recommended.

Asset Sale

In an asset sale, you sell some or all of your business assets to the buyer. Buyers typically prefer this structure because:

- they can select specific assets purchase, which would narrow the transaction to include only assets they deem worth acquiring;
- they can select specific liabilities to assume, potentially reducing their exposure to future issues, such as debts, legal issues, or tax reassessments; and
- they often get a "step-up" in the tax cost of the assets, which increases future deductions for capital cost allowance, reducing taxable income in later years.

For the seller an asset sale usually involves two levels of tax (assuming you are incorporated):

1. at the corporate level the corporation pays tax on any capital gains and on the recapture of capital cost allowance on depreciable assets; and
2. at the shareholder level when the after-tax proceeds are paid out to you (for example, as dividends or on a winding-up), you pay personal tax on those amounts.

In some cases, an asset sale can allow the corporation to add amounts to its capital dividend account ("CDA") and distribute the non-taxable portion of the capital gains as tax-free capital dividends. If it has a GRIP (general rate income pool) the corporation can also pay eligible dividends which benefit from a lower effective tax rate at the personal level.

The tax results of an asset sale depend on the kind of property being sold:

- Inventory – Gains on inventory are fully taxable as business income (minus a deduction for the cost of the inventory);
- Depreciable property – If sale proceeds exceed the undepreciated capital cost ("UCC"), there is a recapture of CCA (capital cost allowance) that is fully included in income, and if proceeds exceed original cost, the excess is a capital gain;
- Accounts receivable – These are generally treated as a sale of a capital asset, though a joint election can be made with the buyer, which would allow you to deduct any loss incurred on the sale of the debts; and
- Non-depreciable capital property – Gains are treated as capital gains.

Typically, a sale of a business is negotiated as a single price, and then the price is allocated among the various assets being purchased. You and the buyer are likely to have conflicting priorities in terms of how the purchase price is allocated. For example, the buyer is likely to prefer a higher cost assigned to depreciable assets, which you would prefer to avoid because that can trigger recapture income. Conversely, a higher allocation to non-depreciable capital property would be beneficial to a seller since it results in lower-taxed capital gains.

If the corporation is the seller in an asset sale, the after-tax proceeds remain in the company until they are distributed. Potential distribution methods to consider include:

- whether tax-free capital dividends can be paid from the capital dividend account;
- whether some or all dividends can be eligible dividends, which are taxed at lower rates than non-eligible dividends;
- whether it makes sense to leave funds in the corporation for investment and distribute them over time to take advantage of marginal tax rates;
- whether the corporation still has a balance of paid-up capital that can be distributed tax-free as a return of capital.

Seller's Tax Status

The tax outcome of a sale also depends heavily on the seller's tax status and attributes, such as:

- Whether the business is owned personally, through a holding company, or by a family trust;
- Whether the seller is resident in Canada. Non-resident status can significantly change the tax results and may trigger withholding tax and other rules;
- Whether the seller or their spouse has already used some or all of their lifetime capital gains exemption in the past;
- Whether the seller has capital losses or allowable business investment losses ("ABILs") from prior years that might offset gains.

GST/HST, Payroll, and Other Issues

While income tax is usually the focus, there are **other tax and legal considerations** when selling a business, especially in an asset sale:

- GST/HST – The transfer of business assets is generally a taxable supply for GST/HST purposes, but a complex election can be arranged that would exempt the supply of the business from being subject to GST/HST;
- Payroll and employment matters – The treatment of employees, continuity of employment, and related source deductions (CPP, EI, income tax) must be considered, especially where employees move to a new employer; and
- Land transfer taxes – If real property is part of the sale, provincial or municipal land transfer taxes may apply.

Weighing Your Options

As mentioned above, buyers generally prefer to purchase business assets while sellers generally prefer to sell shares. In contemplating the sale of a business, it is typical to quantify and then compare the tax consequences of each scenario, which can further inform the seller in the course of the negotiations. For example, if you strongly prefer to utilize your lifetime capital gains exemption, you may incentivize a share sale by offering the buyer a lower purchase price that will still result in higher after-tax proceeds compared to an asset sale.

Conclusions

Selling a business is often the culmination of years – even decades – of hard work. The application of the tax rules is complex and highly situational, but with careful planning, you can ensure that you are maximizing your after-tax proceeds efficiently and avoiding any pitfalls when completing such a pivotal transaction.

Every situation is unique. The right structure and strategies depend on:

- The nature of your business and assets;
- Your corporate and family ownership structure;
- The tax attributes of your business; and
- Your broader financial and estate goals.

Before entering into any agreement to sell your business, it is always best to obtain expert tax, legal, and financial advice. Even if a sale is not yet imminent, it is prudent to have these conversations in advance and plan for the future.