

M&A Structure Checklist: Asset vs. Stock Purchase

This checklist is designed to guide strategic decision-making in M&A transactions, focusing on tax optimization, liability management, and operational continuity based on "The Ultimate Comparison" framework.

1. Strategic Alignment & Transaction Goals

- ☐ **Define Primary Objective:** Is the goal full entity integration (Stock) or acquiring specific intellectual property/machinery (Asset)?
- ☐ **Continuity Requirements:** Does the business rely on non-transferable contracts, permits, or licenses? (Favor Stock if yes).
- ☐ **Integration Speed:** Is a "clean break" required? (Favor Asset for buyers; Stock for sellers).
- ☐ **Management Incentives:** Are key employees being retained via equity rollovers? (Favor Stock).

2. Tax Liability & Basis Step-Up Analysis

- ☐ **Basis Step-Up (Buyer's Priority):** – In an Asset Sale, can the purchase price be allocated to high-depreciation assets to maximize future tax shields?
 - In a Stock Sale, is the buyer prepared to accept the "carryover basis," potentially losing significant depreciation benefits?
- ☐ **Tax Characterization (Seller's Priority):**
 - Will the sale result in Ordinary Income (Asset sale of inventory/depreciated equipment) or Capital Gains (Stock sale)?
 - **C-Corp Double Taxation:** If the seller is a C-Corp, evaluate the impact of tax at both the corporate and shareholder levels in an asset sale.
- ☐ **Hybrid Elections:** – Evaluate IRC Section 338(h)(10) or Section 336(e) elections to achieve a basis step-up in a legal stock sale (requires S-Corp or Consolidated Group status).
- ☐ **Sales & Use Tax:** Ensure "Occasional Sale" exemptions are documented for asset transfers to avoid unexpected state tax hits.

3. Legal Risk & Liability Mitigation

- ☐ **Successor Liability:** – Asset Purchase: Draft the agreement to explicitly exclude "Excluded Liabilities" (e.g., environmental, litigation, past taxes).
 - Stock Purchase: Conduct exhaustive due diligence; the buyer inherits all "skeletons in the closet" by operation of law.
- ☐ **Bulk Sales Law (California Specific):** If an asset sale involves a "bulk" of inventory/equipment, ensure compliance with UCC Article 6 (Notice to Creditors) to prevent creditors from following assets to the buyer.
- ☐ **Indemnification & Escrow:** – Stock deals typically require higher escrow amounts and longer survival periods for "Rep & Warranties" due to unknown entity risks.

- Consider R&W Insurance to bridge the gap between buyer protection and seller exit liquidity.

4. Operational & Third-Party Consents

- [] **Assignment Clauses:** Review commercial leases for "Change of Control" vs. "Assignment" language.
 - **Asset sales** almost always trigger assignment clauses requiring landlord consent.
 - **Stock sales** may bypass these unless "Change of Control" is explicitly restricted.
- [] **Regulatory Licenses:** Check with the ABC (Liquor), CSLB (Contractors), or other agencies. Many licenses must be re-applied for in an asset sale but may "stay with the entity" in a stock sale.
- [] **Employee Retention:** – In Asset sales, determine which employees will receive new offer letters.
 - Comply with **Worker Retention Ordinances** (e.g., Los Angeles or San Francisco) if the business operates in specific service sectors (hospitality, airport services).

5. Valuation & Pricing Incentives

- [] **Purchase Price Allocation (PPA):** Negotiate the allocation between Class I (Cash) through Class VII (Goodwill) assets.
 - Strategic Conflict: Buyers want more allocated to Class V (Equipment – short life); Sellers want more in Class VII (Goodwill – capital gain).
- [] **Working Capital Adjustments:** Define the "Peg" early to prevent price erosion during the closing period.
- [] **Earnouts:** If there is a valuation gap, structure incentives based on post-close performance to align seller's knowledge with buyer's ROI.

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