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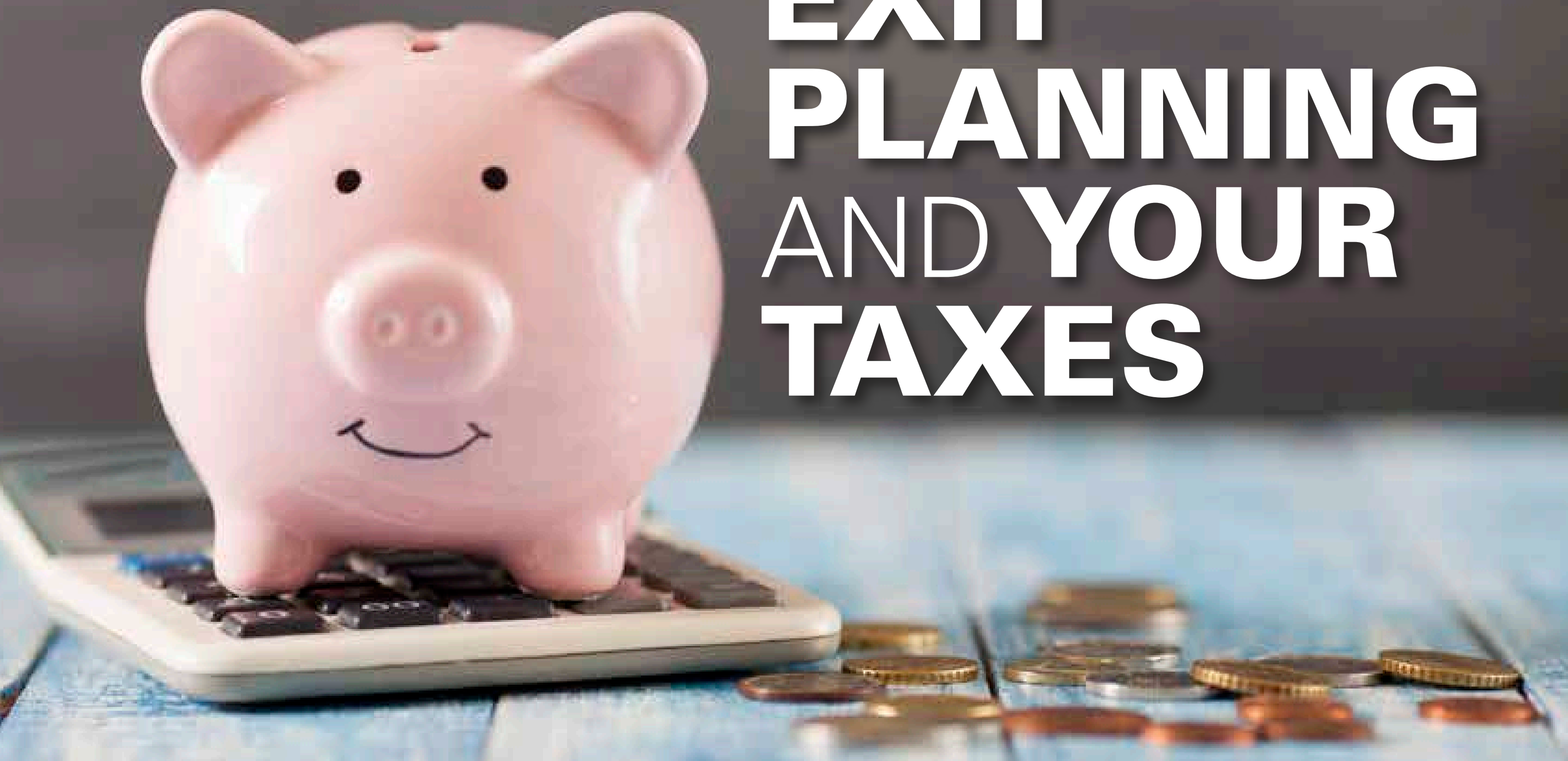
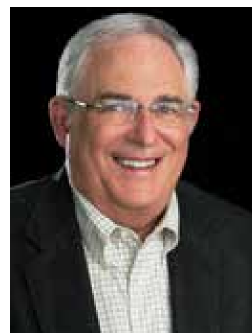


EXIT PLANNING AND YOUR TAXES

The importance of planning ahead when selling your business or passing it down to the next generation



By Steven Bankler, CPA

Are you considering selling your business this year? What about in five years or in 10 years? Believe it or not, it can take a decade of solid planning to exit a business on top, at least when it comes to saving taxes. Business owners who skip exit planning often lose to the IRS more than half of the total amount paid for the sale.

Here's how it can happen: Let's say "Ted" is a C Corp owner who is ready to retire by selling his $1 million worth of stock in the business. The long-term capital gains tax for Ted is a whopping $240,000. And the buyer? His tax bill is even worse. Let's say, in this scenario, the buyer's income tax bracket is set at 37 percent. With federal income tax and net investment income tax combined, the buyer needs to generate an added $690,600 to walk away with that same $1 million in stock. Consider now that this is a family business. All combined, the sale of that $1 million in stock — just to pass it from one generation to the next — cost Ted and his heir $895,600. That's equivalent to a tax rate of 55 percent!

Whether your end-goal is family succession, selling the business, or dissolving it when you retire, start strategizing now and be prepared to change course when needed. We often recommend starting 10 years early because it takes that much time to alter your course from "build mode" to "exit mode." Your corporate identity, the assets you own, and even how you conduct your business all play a role. To get started, consider these areas:

Business Structure
The business structure that's right for you now may not be right for transition. The right business structure (whether it's an LLC or a corporation structure, for instance) can make all the difference when it comes to tax savings and asset protection. But as your business and exit planning needs change, so might the right structure. Plan ahead and be open to changing strategy ahead of the game.

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Capital Gains Versus Ordinary Income
While most sellers think that they want capital gains treatment for the sale proceeds, what they really want is more after-tax dollars. So sometimes paying more in ordinary income taxes, instead of capital gains taxes, can actually increase the net after-tax proceeds the seller receives. Coordination with the buyer could produce better results, higher after-tax funds, and a lower overall tax expense. With this coordination and lower taxes, both the buyer and seller could achieve better results with less cost.

Personal Goodwill
Self-created assets like personal goodwill can now be sold along with the business, but they can (and will) be taxed, too. This personal goodwill can include your reputation, expertise, skill, knowledge and the relationships you've built up throughout the years. The trick is to build up, value and sell personal goodwill separately from the business. The IRS may consider very critically whether the goodwill is personal or whether it's more connected to the business, so careful planning is essential.

Accelerated Depreciation
New tax laws have made it easier to depreciate assets fully. With 100-percent bonus depreciation and the new Section 179 rules, a business can fully expense assets that would have otherwise been capitalized. Prior law only allowed NEW assets to qualify for bonus depreciation, but now both new and used assets can be deducted in the year they are placed into service.

Business Stock
Usually, a business is purchased as an asset, but sometimes only business stock can be sold — as is the case with some corporate businesses that have government contracts that aren't freely transferable. This can lead to quite a few tax headaches for the buyer. However, a tool called the Section 338(h)(10) election can be used to allow the transactions to be treated as an asset sale for tax purposes. This requires careful planning by both the seller and buyer, to ensure the process is beneficial for both parties.

There are dozens of considerations when it comes to tax-proofing the sale of your business — these areas are only the tip of the iceberg. Social Security and retirement benefits, family succession planning, and asset building are all important factors that take time and attention to mature as well. No matter what, you will be exiting your business. You simply need to decide whether it will be on your terms or not.

Steven Bankler has more than 40 years of experience in the accounting industry. Steven's expertise lies in consulting, planning, tax, and asset protection, as well as exit strategy services for closely held businesses. In addition, he also provides litigation support (both as a testifying expert witness and a consulting expert), business negotiations and estate planning. Learn more about Steven Bankler, CPA, Ltd., at www.bankler.com.

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