THE BUSINESS JOURNALS
A DIVISION OF ACBJ

Article Link: http://www.bizjournals.com/bizjournals/how-to/sell-a-business/2015/05/tax-questions-when-selling-your-business.html

Tax questions to consider when selling your business

May 4, 2015, 11:27am EDT

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Since federal and state taxes are often the largest "cost" of the business sale, here are three questions for business owners to ask themselves now – long before the sale negotiations begin – to maximize the proceeds from the sale.

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1. What will the structure of my sale be?

The structure of the sale (i.e., stock sale v. asset sale) greatly affects the tax that will ultimately be owed. Depending on the structure, the transaction may be subject to capital gain or ordinary income from the sale of each asset, as opposed to simply capital gain on the sale of the stock.

2. What are the income tax benefits or consequences of my business structure?

The entity structure (C or S corporation, LLC, partnership, etc.) also greatly affects taxation, and may even drive the sale structure. For instance, a stock sale usually results in capital gain, but if assets are sold by a C corporation, the gain may be taxed at both the corporate level and the shareholder level upon liquidation, possibly resulting in more than a 50 percent total tax. In addition, the proper allocation of the purchase price to capital gain items, such as goodwill, can reduce the overall taxation of the sale.

3. What other taxes will impact me?

The "Obamacare tax," technically called the net investment income tax (NIIT), must be considered when selling a business, since it usually operates as an additional capital gain tax. If a business owner is selling stock in a C corporation, this tax will be owed. However, if the stock is being sold in an S corporation and the owner is active in the company, the income from the retained interest should not be subject to the additional 3.8 percent NIIT.

In addition to federal income taxes, each state provides its own rules for taxing an entity and its owners. Regardless of where the business is located, the laws of each state in which the business operates and/or holds property may need to be considered when preparing for the sale of the business.

It is imperative that owners consider the tax opportunities of selling a business and be prepared to address such obstacles head-on long before the actual sales process takes place. The earlier these issues are addressed, the more the business owner is likely to keep – and the less the IRS may get.

Christopher A. Steele contributed to this article.

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