Selling Your Business?
3 Tax Strategies for Entrepreneurs

Are you an entrepreneur thinking of selling your business and moving on to your next big thing? Then it's time to look at the tax implications. Sellers are typically hit with a variety of taxes: income tax, state and local sales tax, capital gains tax, and eventually perhaps estate taxes. The type of taxes you pay — and when — largely depends on what you are selling, how the sale is structured, and what you do with the proceeds. This makes it critical that you have the right financial framework in place for both the sale and the proceeds. And of course, the framework is valid only if it can enable the life you want, well into the future.

Tax Planning Is a Must

Here are three key things to consider when developing a tax plan to sell your business:

1. What is being sold and who is selling it?
2. When will the sales proceeds be received?
3. What will you do with the proceeds?

What is being sold and who is selling it?

Let's start with "what" is being sold. You can sell ownership of your business, i.e.., the stock or partnership interest, or you can sell the assets of the business. Usually, it is tax-beneficial for the seller to sell ownership of the business (by selling shares of its stock or units in a partnership or LLC). The profits are generally taxed as capital gains, which have a lower tax rate (20% maximum) than regular income. Selling ownership of the business also means any liabilities associated with it are passed on to the buyers.

In some cases, certain assets of a business that operates as a partnership or an LLC (Limited Liability Company) do not qualify for capital gains treatment. This includes any inventory, as well as any assets that can be depreciated (equipment, real estate, vehicles). The profit on such assets is considered ordinary income and taxed at the seller's highest marginal tax rate, even when it's ownership of the business that is being sold.

Buyers have an incentive to characterize as much as possible of the sales price as the sale of business assets (not ownership). This allows them to depreciate the assets purchased and avoid some of the liabilities of the business. Sellers usually have the opposite goal – to have the entire sales price characterized as sale of ownership. This usually results in the lowest tax bill for the seller, since profits on the sale are then taxed at the capital gains rate.

The "who" question

The "who" question also affects the tax bill. If you are sole owner of the business being sold, all of the gain is taxed to you. But if the business has multiple owners, the gain is spread out. It is a slightly longer planning process to arrange for transferring business ownership prior to a sale (for the ownership transfer to be recognized, it should be in place before talking with a buyer). Structured

properly, the sale of your business can present a great opportunity to pass some wealth on to family members or a favorite charity, while reducing your own taxes. Some transfers of ownership, such as to a charitable trust, can even help defer your tax bill to future years, while providing a current-year income tax deduction.

When will the sales proceeds be received?

Accepting the entire purchase price at closing presents the lowest risk because it eliminates the possibility your buyer won't be able to pay the remaining balance. However, payoff at closing also forces you to report all of the gain in one tax year. This is likely to push you into the highest income and capital gains tax brackets.

One of the most common ways to reduce the overall tax liability from a business sale is to receive payment over more than one tax year. For tax purposes, you can then report much (if not all) of the gain from the sale over time, as the proceeds are received. By doing this, you are likely to lower your overall tax rate on the proceeds.

Seller-financed loans, earn-out payments and similar strategies sidestep higher tax brackets by avoiding the single-year tax liability trap. The caveat is that you will need collateral or other guarantees to protect your interests should the buyer fail to make scheduled payments
Keep in mind that deferring receipt of the proceeds can sometimes get you a higher sales price and some interest income as well.

What will you do with the proceeds?

During the year (or years) that you are receiving the sales proceeds, you should minimize income and gains from your investments and other assets. Do not make the mistake of timing a sale to close in a year during which you also sold a large amount of stock for substantial gains. Finally, certain tax-efficiency strategies in your investment portfolio can help minimize gains, including tax-loss harvesting (using realized losses to offset gains).

The bottom line

Selling your business tax-efficiently can be done, but it takes some strategizing. By understanding the tax consequences of the sale in advance, you can avoid costly surprises later — when it's too late to prevent a major bill from the IRS.

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