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Exit Planning for Business Owners

The Ten Deadly Mistakes

To those of you who are paying attention to this series, this is the issue we skipped during tax season.

Part Six:

The Owner Wants to Retire & Sell the Business to a Family Member, But There is not Enough Time to Make the Transfer and Pay Minimal Taxes.

The business owner works for many years building a business that, in many cases, becomes his most valuable asset. Because the owner was diligently working **IN** the business rather than **ON** the business, retirement is not on his radar screen.

Planning and timing are critical to leaving your business with enough money to support you in retirement. How much money will there be after paying taxes and other related sale expenses? Will it be enough to support the life style you want during retirement? Do you want to gift the business to a family member or get paid a fair price?

Here is what Richard P. Goldstein, CPA, of Aronson & Company has to say:

If your long-term strategy is to build a prosperous business and sell it, you may want to consider electing S corp status. A sale of a business often takes the form of an asset sale. If the business sells assets as a C corp,

there is generally a double tax; once at the business level and then again when the company is liquidated and cash is distributed to shareholders in the form of a liquidating dividend. However, an S corporation is a flow-through entity and the tax on asset sales is passed through to the shareholders. So the long term strategy would be to elect S corp status to get the most favorable treatment in an asset sale.

If you are just starting out, electing S corp status can be done by having all the shareholders consent to elect S corp status. If you have an existing C corporation and want to convert to S corp status, it's a little trickier. The IRS doesn't want taxpayers to elect S corp status prior to an asset sale in order to avail themselves of the single tax. Therefore the gain on the value of the business at the date of conversion will be taxed twice, while the gain from date of conversion gets the flow through treatment. The IRS calls this additional tax a "built-in gains" tax. If you make the conversion from C to S corp and don't sell the assets within a ten year period (reduced to 7 years for 2009 and 2010 conversions) then the transaction is taxed as an S corp asset sale with a single level of taxation and no built-in gains tax.

As you can see from the above discussion it is important to have the proper tax and legal planning so that the sale of the entity is structured correctly. In addition to the above considerations proper tax planning for the sale of the business would include assigning values to the various components of the sale, such as valuing the assets, goodwill, covenant not to compete, ongoing services by key employees.

In any sale (or conversion of C corp to S corp) it's important to consider an appraisal of the business by a professional who specializes in valuing businesses. The valuation is important in determining a fair market value for the business, as well as being useful in assigning values to the various components of an asset sale.

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The day you enter business ownership is the day you should start planning to leave your business. Those who follow this rule maximize on their investment when they transfer ownership.

Call Lou Kastelic at Jordan-Crandus, P.A. for a free initial consultation.

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