

PUBLISHED BY



Author: Chris Vanderzyden - President & CEO of Legacy Partners, Division of The DAK Group

Maximize the Money You Keep After Selling Your Business: Tax Mitigation Strategies for Savvy Business Owners

Every day, entrepreneurs like you take on significant risk, pouring your time, capital, expertise, and sweat equity into building a successful business, only to hand over a growing portion of your profits to Uncle Sam each year. And when you exit your business? That liquidity event will most likely be the largest tax bill you will ever see.

But there's good news. With proper tax planning now, you can minimize future tax implications when you do sell your business—and pocket a larger portion of the sale proceeds. Let's look at some of the ways you can do this.

Add a Separately Managed Account to Your Investment Portfolio

A separately managed account (SMA) enables you to own individual stocks. With the right investment strategy, it can be a highly effective tool to limit or reduce capital gains. Wealth management firm Heritage Financial, a strategic partner of Legacy Partners, unpacks this strategy in their blog "Selling Your Business? Tax Strategies to Keep More of What You Earn."

Apply a Tax Mitigation Strategy to Your Deal Structure

Some tax mitigation strategies are specific to the deal structure of a business sale. For example, we currently

have a client whose transaction includes a roll-over of equity. For tax purposes, we advised the deal structure include an **"F" reorganization**. With this deal structure and tax strategy, the client's S-corporation is legally converted to a limited liability company (LLC) before it is sold. The buyer receives a step-up in basis on the assets upon acquisition, which increases depreciation and amortization to offset taxable income thereby increasing future cash flow. More importantly, the seller, (our clients) benefit from the ability to defer the taxes on the equity roll.

A **338 (h) (10) election** is a structure that benefits a buyer with a step-up in basis but does not give the seller a tax deferral on the equity roll. In this situation, the deal team will negotiate with the buyer for a "gross-up" in the purchase price to compensate our client for the increased tax burden.

More Tax Strategies to Consider

Here are three more categories of tax strategies that can help you minimize the impact to your taxes.

1. Estate Freezing and Transfer Techniques

These strategies freeze the value of the business at its current valuation and transfer the asset to the children. When the business sells in the future, after it has appreciated, the gift or inheritance tax is mitigated on the liquidity created from the appreciation.

Here are the strategies most commonly used:

- **Annual Gifting** – You can transfer up to \$19,000 of stock to an individual.
- **Installment Sale to an Intentionally Defective Grantor Trust** – All or part of the business is sold to an irrevocable trust to benefit the children in exchange for a note. When the business is sold, the note is paid off to the seller. The growth in business value since the transfer date remains in the trust to benefit the children, free of gift and estate tax.
- **Grantor Retained Annuity Trust (GRAT)** – Shares of the business are transferred to a trust in return for an annuity, typically equal to the value of the shares. Upon sale of the business, subsequent appreciation passes to the beneficiaries free of gift and estate taxes.
- **Charitable Lead Annuity Trust (CLAT)** – Shares of the business are transferred to a trust that pays an annuity to a charitable organization. At the end of the annuity term, the remaining value passes to the noncharitable beneficiaries (the children in most cases), and the appreciation of the remaining interest for the family benefit is free of gift and estate taxes.

2. Rollovers, Exclusions, and Tax Deferrals

Unlike the previous strategies that require the business owner to enter into a transaction and create a special legal entity, taking advantage of the following tax codes may be effective.

S 1042 – “Tax Free” rollover from the sale of a business to an employee stock ownership plan (ESOP). This strategy defers federal tax (and sometimes state tax) on the transaction by rolling proceeds into a qualified replacement property (QRP), such as stocks or bonds of a domestic company. The deferred taxes are then extinguished at death when the children receive a step-up in basis.

S 1202 – Capital gains exclusion allows a small business owner to exclude up to 100 percent of gain, capped at \$10 million or 10X the basis held for five years or longer in a qualified small business stock (QSBS). A QSBS is a domestic C-corporation with a gross asset basis that does not exceed \$50 million.

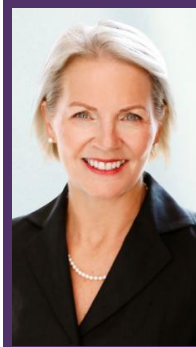
S 1045 – Rollover of a taxable gain of a QSBS into another QSBS within 60 days, deferring the recognition of gain until the new entity is sold.

3. Income Tax Mitigation

The following options help you minimize the impact to your income taxes.

- **Qualified Opportunity Zone Investment (QOZ)** – Capital gain reinvestment in a QOZ fund within 180 days of the sale of your business will defer your capital gains tax until December 31, 2026, if your interest in the fund is disposed of before this date. If the funds in the QOZ remain for 10 years, the appreciation on the invested proceeds is excluded from federal capital gains tax.
- **Interest Charge Domestic International Sales Corp (IC-DISC)** – An entity is created to enable exporters to convert ordinary income from sales to foreign, unrelated parties into qualified dividend income. The income is taxed at the capital gains rate rather than ordinary income tax rates.
- **Incomplete Gift Non-Grantor Trust (INGT)** – This is a trust structure that allows a business owner to shift tax exposure from high tax states, such as New York or California, to low tax states, such as Florida or Texas. This trust is designed to be an incomplete gift for gift tax purposes and, for state income tax purposes, as a separate taxpayer resident in a state with favorable trust income tax laws.

As you prepare your 2024 taxes, consider the impact that selling your business will have on your tax obligations. With proper planning well in advance of selling your business, you can develop and execute the right tax strategy that can save you millions when you do sell.



About

Chris Vanderzyden

Chris Vanderzyden leads the Legacy Partners Worldwide Division of The DAK Group. She is a trusted advisor to clients and peers, an industry trailblazer in exit planning, and a mentor and leader to a team of top financial and M&A professionals. She can be reached at cvanderzyden@legacypartnersllp.com