MINIMIZING TAXES WHEN SELLING YOUR BUSINESS

One of the most important issues we face when representing a client selling the assets of his business is how to minimize taxes due on the sales proceeds.

Ordinary income tax rates are now approaching 50% (between Federal and New York State), and are even higher for those living in NYC. Therefore, it is important to minimize the amount of sales proceeds that are subject to ordinary income tax rates. In many cases, we are able to structure transactions so that the vast majority of the sales proceeds are subject to the lower capital gains tax rates (approximately 31% between NYS and Federal), instead of the much higher ordinary income tax rates.

An even better result can be attained with proper planning.

By implementing a Cash Balance Plan (or a traditional Defined Benefit Plan) prior to the sale of a business, a significant portion of the sales proceeds can be deferred from current taxation. Consider the following facts of a recent transaction in which we represented the seller of a manufacturing company.

The business was established as an "S" corporation and was owned by one stockholder. The business maintained a 401(k) plan for its 5 employees. The average age of the employees was 42. The stockholder's average annual compensation was $500,000. The stockholder planned on selling his business by the time he attained age 65.

When the stockholder attained age 61, our firm designed a Cash Balance Plan for the business to complement its existing 401(k) plan. The Cash Balance Plan was designed to generate small tax deductions (approximately $20,000 a year) for the first 3 years. The stockholder received an offer of $2,000,000 for the assets of his business when he was age 65. Prior to the sale, the actuarial formula under the Cash Balance Plan was amended to generate much larger tax deductions so that in the year of the sale the tax deduction afforded under the Cash Balance Plan was $900,000, leaving only $1,100,000 subject to capital gains tax rates.

Since the stockholder does not need to begin taking minimum required distributions from the Cash Balance Plan until he attains age 70-1/2, the $900,000 Cash Balance Plan contribution will grow tax deferred for more than 5 years.

Please call Robert B. Danziger , Esq. or William Miller, M.S.P.A, M.A.A.A. if you would like to discuss minimizing taxes on the sale of your business.

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