

Greetings!

Please take a moment to review the valuable content in our newsletter.



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## "REFLECTING AGAIN"...

By Morgan Vaive &

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Last November we made the title of this Newsletter "Reflecting." With all that has happened this year it just seemed right to use the same title.

2020 has certainly been a year like no other. It started great and soon changed with Covid. We've had Covid related deaths, business closures, re-structures and many lost jobs.

Working remote has become the new norm for much of the workforce while many schools are conducting some or all virtual classes. Everyone has had to adapt in in some way or fashion.

We all might need to take some time to reflect on how we have been impacted by these things. Whether professionally or personally we have been forced to make different decisions that impact ourselves, others, and our

## C-CORPORATION TAX IMPLICATIONS WHEN SELLING A BUSINESS

When you acquired or started your business years ago, you made a choice, perhaps with the help of an accountant or attorney as an advisor, as to the type of business entity you would operate as. Chances are you incorporated as a regular corporation (a C-Corporation). There are two major reasons C-Corporation status might have been chosen: (1) C-Corporation tax rates are typically a little lower than individual rates (below approximately \$100,000 in taxable income); and (2) start-ups typically need to re-invest much of the profits in the growth of the business, as opposed to distributing the profits to the owner.

### C-Corporation Tax Implications

**The tax implications of a C-Corporation sale of assets are downright ugly! Brace yourself, the favorable capital gains tax is not available for the sale of C-Corporation assets**

Unfortunately, when it's time to sell the business, from a tax standpoint a C-Corporation is by far the worst type of entity. Most owners assume when they sell their business they will be taxed at a lower capital gains rate. If you are not a C-Corporation (subject to other tax provisions, such as depreciation recapture), for

businesses. During this time of reflection, it can be difficult to know if you made the right decisions or even what decisions you still may need to make.

Our business is to consult our Clients which consist of Business Owners, Business Buyers, and many other types of professionals. We often advise them with truths that they don't want to hear or even offer opinions that they may disagree with. To best serve them we are obligated to give our honest and professional opinions while always doing what's in their best interest, not ours. Are we perfect? No, but in everything that we do, we do it with integrity.

November also has Thanksgiving which could arguably be one of the best if not the best Holiday. It's a time for food, Family, Friends and simply a time to reflect on the many good things in our lives. It's a time to be thankful for having the opportunity to engage with so many good people. It's also a time to look ahead to what we will do and as always, to try to do it better.

As Peter Drucker said: "Follow effective action with quiet reflection. From the quiet reflection, will come even more effective action."

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the most part, that may be true. However, there is no lower capital gains tax for a C-Corporation. The gain on the sale of the assets of a C-Corporation is taxed at normal corporate rates, which usually ranges from 34% to 39%, and there are more taxes to come! When the corporation sells its assets, the net proceeds after the corporate taxes belong to the corporation, not the owner. When those proceeds are paid out of the corporation to the owner, they are taxed again. If you've heard the term "double taxation," this is the scenario it refers to.

For owners who fail to plan for the sale of their business and who need to sell relatively quickly, there's not a lot that can be done. Many are forced to deal with it and sell anyway. Others, who really should sell, defer the decision and ultimately are never able to sell because they let their business situation deteriorate.

### **Flow-through Entities**

Most small business sales are structured as the corporation (or entity) selling its assets. For entities other than C-Corporations (such as S-Corporations, LLCs and partnerships), the sale is not taxed at the corporate/entity level, but instead flows through as personal income to the business owners, and a substantial portion of the proceeds may qualify for capital gains tax.

### **A stock sale of a C-Corporation is not easily accomplished**

To avoid double taxation of a C-Corporation and achieve capital gains taxation, a possible alternative is for the C-Corporation owner (stockholder) to sell his shares of stock in the corporation (as opposed to the corporation selling its assets). Unfortunately, that option is not easily accomplished. Buyers and their advisors are usually reluctant to consider a stock acquisition for two primary reasons: (1) the buyer assumes responsibility for all liabilities

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## ***NEXT ISSUE***

# Achieving a Partial C- Corporation Tax Benefit

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of the corporation, including any unknown past liabilities; and (2) there are significant tax disadvantages to the buyer from the standpoint of depreciation. In addition, many small business corporations have inadequate records of compliance with regulatory issues, or other "skeletons in the closet" that preclude the possibility of a stock sale. Depending on circumstances, a sale of C-Corporation stock may be possible, but it may be unlikely.

### **10 year transition period**

So, why not just switch from a C-Corporation to an S-Corporation or LLC? It might be a good idea. But, here's the killer ... if you sell the business within 10 years of making that switch, you'll be taxed as a C-Corporation as if you never made the switch! **Yes - 10 years.** The Internal Revenue Service doesn't make it easy. (However, there is a complex way to achieve a partial tax benefit if you sell in less than 10 years after switching from a C-Corporation. We'll discuss that in our next issue.)

Over the years, I've surprised many, many owners when informing them of the tax consequences of a sale in light of their C-Corporation status. It is a very common obstacle that few business owners are aware of and takes a considerable amount of time to overcome. It may be the very best argument for the importance of planning your exit strategy from the day you start the business.

We probably should talk today about your current salability and an exit plan. No obligation. Just prudent advice.



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