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**Zoellner, Garten & Co.**  
Cincinnati & Dayton OH  
513-852-2400  
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*December 2020*

## "LOOKING AHEAD"...

By Morgan Vaive &  
John Zoellner, BCA, MCMEA

As this infamous year of 2020 nears its end, we can't help but think of how excited we are to turn the page and welcome a much better 2021.

What will 2021 be like? From a business perspective there are always unforeseen events to occur that most certainly will have to be dealt with. For example, how will the election in November affect businesses?. What will the economy be like? What about interest rates, unemployment, tariffs, and taxes? Will Covid continue to affect a lot of businesses and how they operate?

There never seems to be a shortage of speculation or questions. What should we as business owners rely on? How should we manage our Businesses? What should our 2021 Budget look like? What adjustments should we make going forward based on what we learned in 2020?

There are no simple or perfect answers to any of these questions. What we can do is focus on what we can control and influence. We must continue to provide the best products and services at prices that work for all. Most importantly we must keep open communication with employees, customers, vendors, and other financial and legal business partners. We benefit from their input and expertise and that might make the difference between future success and failure of our businesses. This is also relevant when considering selling or growing your business.

Whether you find yourself contemplating selling your business or growing your business via acquisition, we can help. We not only do business appraisals, but we are also ready and skilled at advising you with the sale of your business or an acquisition to grow it. If this is the time, we are here and available - please contact us. We are confident that 2021 will be better than 2020!

**Morgan Vaive, Vice President**  
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## Achieving a Partial C-Corporation Tax Benefit

If you recall from our last issue, the "double taxation" of C-Corporations result in horrendous tax implications in a business sale of their assets. First the corporation pays a tax on the gain from the sale which typically ranges from 34% to 39%. Then the net proceeds, after the corporate tax, are taxed again when the monies are distributed to the owners of the business.

### 10-year transition

Non-C-Corporations, such as S-Corporations, LLCs and partnerships ("flow-through entities") are not taxed at the corporate/entity level, but instead the profits/gains flow through as personal income to the owners of the business, and a substantial portion of the proceeds may qualify for capital gains tax. Unfortunately, if you change from a C-Corporation to a flow-through entity, the Internal Revenue Service has a 10-year "built-in gain rule," which still taxes the sale of the corporation's assets at the "double-taxation" C-Corporation tax rates if those assets are sold within 10 years from the date of the S-Corporation election.

### Built-in gain

Wow, that last sentence is complex. That's because the regulations are complex. And the complexity grows. If you can document the "built-in gain" as of the date you make the change, your C-Corporation tax will be limited to that "built-in-gain" and any future appreciation in value of those assets will be taxed as an S-Corporation. That means you need to appraise your hard assets and also appraise the value of your business as of the date you switch to an S-Corporation, so you have records indicating the amount of the built-in-gain.

### It is not unusual for goodwill to be a substantial portion of total business value

Due to high levels of Seller's Discretionary Earnings (SDE) most successful businesses have a fair market value more than the value of their hard assets. As a simple explanation, the value of the business more than the value of the hard assets is known as goodwill, which is typically the portion of a business sale that is taxed at capital gains rates in flow-through entities. For example (again, simplifying the complexity), if a business has \$300,000 in assets and the business is worth \$1,000,000 based on its SDE, the goodwill

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## **NEXT ISSUE**

### ***Inadequate Record Keeping, Accounting Systems & Financial Reports***

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value is \$700,000, most of which will be taxed at capital gains rates for a flow-through corporation. Especially for successful businesses, it is not unusual for the value of goodwill to be a substantial portion of the total value of a business.

#### **Obtain a professional business appraisal when changing to a flow-through entity**

In all this complexity, here's the key point. If you anticipate the value of your business will grow substantially in the next few years, the value of your goodwill is likely to increase significantly. As part of your exit strategy planning, it may be beneficial to change from a C-Corporation to an S-Corporation. If you and your advisors determine it is advantageous to do so, and there is a possibility you might sell the business in less than ten years, it's a good idea to have your business appraised to identify the "built-in gains" as of the changeover date.

In many circumstances, the tax savings of exiting your business as an S-Corporation versus a C-Corporation can be substantial. But this is a complex issue that requires advice and analysis by an experienced and competent tax professional. If you own a successful business that operates as a C-Corporation and intend to sell it at any point in the future, you should find a professional tax consultant to discuss the advantages, disadvantages, and tax implications of a conversion to an S-Corporation.

Is your business organized as a C-Corporation? If so, get some professional tax advice today. We can help.

Dear Paul,  
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