Planning Opportunities For Business Owners

If you own a business or a farm, the day may come that you will want to sell it. You created the business to make a living for yourself and to provide value for society. Someday, you may wish to walk away, cash out your equity, and retire.

When that time comes, you could face a hefty tax bill. The sale of a business is subject to capital gains tax on the appreciation of the value of your business. The tax rate for long-term capital gains can be as high as 23.8 percent (20 percent capital gains + 3.8 percent Net Investment Income Tax surcharge). And because most businesses have a very low cost basis, most if not all of the value of the business can be taxed at this 23.8 percent rate.

Think about that. You scraped together whatever money you could to start the business. You took risks. You invested your time and energy, your blood, sweat, and tears. And, against all odds, you succeeded. You built a business. You served the community, created jobs, spurred the economy, and generated tax revenue along the way. And yet, at the time of sale, nearly a quarter of the value of that business could flow to the Internal Revenue Service.

Unless you plan ahead.

What if you could reduce the size of that tax bill? What if you could shrink it to a much smaller amount—or better yet, eliminate it altogether?

You can.

There is a limit to the amount of equity you and your loved ones can receive. Basically, it's the amount that remains after the taxes are paid. However, you have a choice in how you spend the rest. You can give it to the IRS (expense), or you can give it to your favorite ministry or charity (eternal investment).

Here's what that might look like.

The sale of a business could easily represent the single largest influx of spendable cash you've experienced in your lifetime. Many of the people I've worked with over the years have several ideas about what they would like to do with that money, which typically include several of the following objectives:

1. **Celebrate.** They may wish to spend some of the money on a party or a nice trip.
2. **Retire.** Establish a comfortable investment portfolio to see them through their retirement years.
3. **Give to loved ones.** If there are children or grandchildren, the business owner may want to arrange special gifts for them, such as debt reduction, supplemental income, education funding, or retirement funding.
4. **Give to ministry.** Many people I've met choose to make significant contributions to beloved ministries that are carrying out the work of the Lord. Some tithe, and some give even more. They see this event as an opportunity to write perhaps the largest check of their lives and to make an even greater impact. (Some contribute to a Donor Advised Fund through which they can make donations over the course of several years.)

When planned properly, charitable giving can significantly reduce the capital gains tax bill on the sale of the business. For those who would like to consider gifts to ministry in their plan, they should consider giving away equity in the business before it is sold, rather than giving away cash after the sale.

At the time of sale, the capital gains tax is the responsibility of the one who owns the asset. By giving away some of the equity prior to the sale, the business owner can give away a proportionate amount of the capital gains tax. This one switch to making the donation before the sale instead of afterward could result in significant tax savings. (For example, for every $100,000 of equity donated prior to sale, the donor could avoid as much as $23,800 in taxes, assuming a zero cost basis on the business.)

Another tax benefit of donating business equity is the ability to take an income tax deduction for the appraised fair market value of the donation. This tax deduction can help offset any remaining capital gains tax on sales proceeds retained by the business owner.

Something else the business owner might consider is the establishment of a Charitable Remainder Trust (CRT). Certain types of business property, such as real estate, some LLC shares, or certain types of company stock, can potentially be used to fund a CRT. Donating such assets to the CRT prior to the sale of the business can not only shelter them from erosion due to capital gains taxes but also provide a partial income tax deduction.

Here's an example of a tax-efficient plan that could enable a business owner to accomplish all desired objectives while significantly reducing (even eliminating) the net taxes on the sale of the business.

Assuming a $10 million business sale:

- $1 million—Splurge, celebrate, give to family and loved ones. (Taxable)
- $1 million—Donate to charity prior to sale, either outright or through a Donor-Advised Fund. (Bypasses Capital Gains Tax and provides a full Income Tax Deduction.)
- $4 million—Retain. Invest for annual income of $200,000 at 5 percent. (Taxable)
- $4 million—Charitable Remainder Trust, with an annual income of $200,000 at 5 percent. At death, the remainder is paid to selected charities. (Bypasses Capital Gains Tax and provides a partial Income Tax Deduction.)

Notice that with a plan such as this, some elements will be taxable, some will bypass capital gains taxes, and some will be tax deductible. In the scenario above, all the capital gains taxes on the retained proceeds would likely be offset by the income tax deduction on the outright charitable gifts and the Charitable Remainder Trust. The result is zero net taxes to the business owner.

This presents only a basic overview of certain key concepts. Each situation is different, and everyone's plans are different. The primary takeaway is that you have options, and it's important to understand your options prior to selling the business. If you wish to include charity in your plan, then the proper timing of your charitable gifts can significantly reduce your tax bill, allowing you to use the money to fund kingdom investments instead of taxes.

If a liquidation event is in your future—even if it's several years away—then let's talk. We can review your goals, discuss details, and help you explore your options and opportunities.