

Proposed Tax Increases Cause Business Owners to Reconsider How to Exit

"If I'm a business owner, I'm walking away from this week with. . . thoughts. . . if I don't plan on continuing to hold the business for the long-term, I better expedite my exit strategy when capital gains, the Net Investment Income tax, and tax surcharge become law."

The House Ways and Means Committee has recently issued its income tax proposals that will help fund the Biden Administration's new government investments. These potential changes to the corporate income and capital gains, and other income-based taxes, could have significant implications on small businesses and their owners. If implemented, many of these provisions will go into effect retroactive to September 13, 2021, and others are effective January 1, 2022. Therefore, business owners that have been looking to sell their businesses should plan now before an additional increase in taxes is added to the proposal. Failure to act can severely diminish the proceeds from the sale of the business.

The current plan suggests raising the corporate tax rate for C Corporations from 21% to 26.5% (graduated). This proposal would be effective for taxable years beginning after December 31, 2021. If C Corporations are





indeed subject to a higher corporate tax rate, there could be a reversal in how small businesses incorporate in the future. Karen Kerrigan, President of the Small Business & Entrepreneurial Council, believes that these tax increases will significantly hurt small businesses, especially those just getting back on their feet after the pandemic. "The foundation is established for a great economic recovery and bounce back to pre-pandemic levels but toying with tax rates at a time like this has a dampening effect," says Kerrigan. Small to mid-sized businesses want to operate in a stable environment, but this tax uncertainty makes it difficult to plan.

Another proposed change, beginning in 2022, is a 20% pass-through deduction for S Corporations and partnerships at a maximum allowable deduction of \$400,000 for single taxpayers and \$500,000 for married filing joint taxpayers. This, combined with the proposed increase in the top individual rate from 37% to 39.6% in 2022 for income over \$400,000 for single



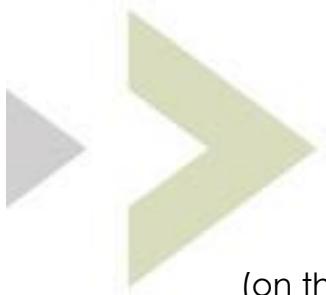


taxpayers and \$450,000 for married filing joint taxpayers, poses major tax planning issues for 2021 and beyond.

Along with raising the corporate income tax, the House Ways and Means Committee plans to increase rates for long-term capital gains from 20% to 25%, imposing a Net Investment Income Tax of 3.8% (to include income derived from a trade or business), and add a new 3% surcharge on all income over \$5,000,000. The sum of these changes could increase taxes on the sale of a business by 50% or more! Business owners looking to exit should seriously consider planning the structure of a business sale to take advantage of the tax changes.

Let's look at an example. Say you're selling your business for \$10 million with a basis of zero. Because income is over \$5 million, half of the proceeds will have a 3% surcharge. If you were to sell in 2022, \$10 million (business sale proceeds) - \$10 million of capital gains being taxed at 25%, a 3.8% Net Investment Income Tax surtax of \$ 380,000, and a 3% surcharge

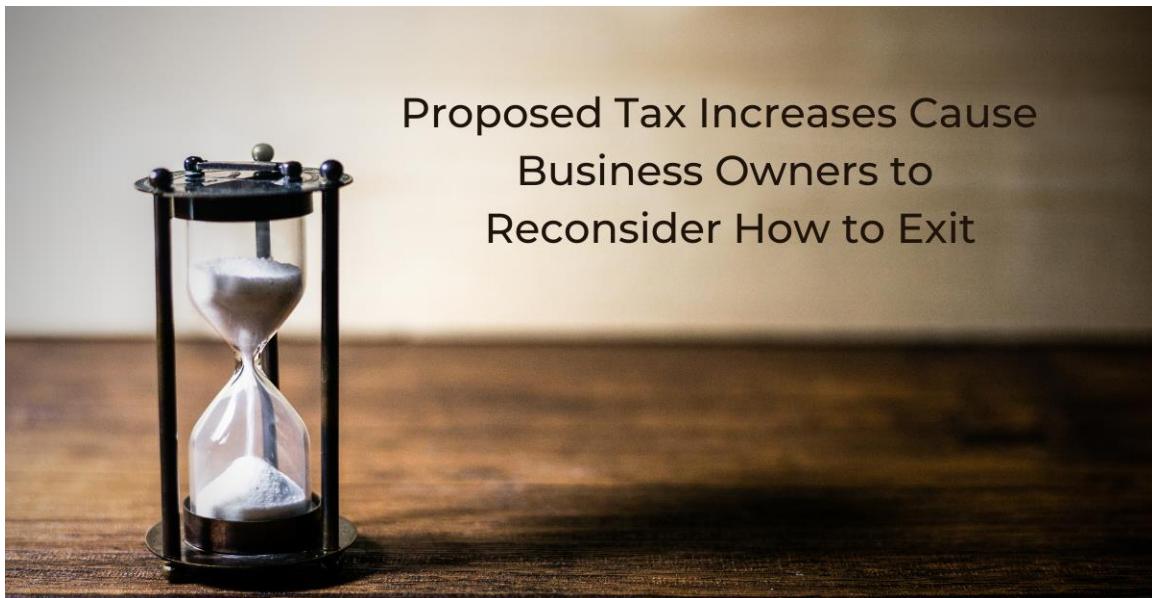




(on the amount over \$5,000,000). This yields over a \$3 million tax bill on the sale. If the business were to sell before the end of 2021, the \$10 million of gain would be taxed at just 20%, causing only \$2,000,000 to be owed. In this scenario, structuring the sale to take advantage of the proposed tax changes obviously results in significant tax savings. We have the tax professionals that can walk you through your taxable event and structure a deal to minimize the taxes you pay, allowing you to 'retire in the lifestyle' you've earned.

When you exit, you need someone who understands your goals, your years of hard work, and the difficulties of selling a business. As an investment bank for entrepreneurs, Strategic Exit Advisors understands the complexity of the proposed tax changes. We help owners achieve their ultimate exit by focusing our process on strategic buyers willing to pay higher, strategic multiples. The first step to your ultimate exit is just a phone call away! Give Strategic Exit Advisors a call today.





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