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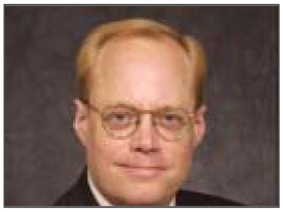


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THE TAX LAWYER


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# But Who Pays Tax On Business Sale?

Sound like a silly question? The sale of a business is usually a big event in the owner's life, financially, emotionally, and in other respects. As I noted here, taxes are key to business sales, but *who* pays them? Some business owners work for years, decades or even a lifetime and sell a business only once. Others build and sell multiple businesses, buying or selling every few years.

Regardless of the form in which you conduct business, proprietorship, partnership, limited liability company (LLC) or corporation, a fundamental question is whether you are selling the stock or assets of the business. Actually, the "stock or assets?" question implies you are operating in corporate form. In that case, you could sell the stock or the corporation could sell its assets.

If the business is operated as an LLC, you could sell membership interests (the units the members of the LLC hold) or the LLC itself could sell its assets. If the business is operated as a partnership (whether general or limited) the sale could be made by the partnership (a sale of assets). Alternatively, the partners could sell their partnership interests.

You might think all these avenues lead to the same place, but they come out differently. If you sell corporate stock, you are selling a security. If you sell all the stock, you change who owns it, but the company is still in place and still owns its assets.

**Follow the Money.** The same would be true if you sell a partnership interest or LLC membership interest. Even if all the owners sell their interests, the entity would still own the assets. To see the tax differences between these mechanical variations, follow the flow of money.

If a partnership, LLC or corporation sells assets, the purchase price is paid to the entity. The entity may or may not distribute the sales proceeds to the shareholders, members or partners. But whether or not the money is distributed, the payment to the entity will have tax effects.

To assess it, you'll need to know the tax basis of the assets in the hands of the entity. The tax basis is the purchase price the company paid for the assets, less accumulated depreciation, plus certain adjustments.

> ***Example*:** Suppose the business entity sells its assets for $5 million. To determine taxes you need to know the business' basis in these assets. If its basis is $2 million, there's a $3 million gain. If its basis is $6 million, there's a $1 million loss. Sometimes this kind of basis is known as "inside" basis, meaning the tax basis inside the entity.

Depending on the type of business entity, this gain may be taxed to the entity or to the partners or members. For example, if a C corporation sells its assets for $5 million with a $2 million basis, that $3 million gain will be taxed to the corporation at up to 35%. That will leave only about $3,905,000 for distribution to shareholders.

If an LLC or partnership sold the assets for $5 million at a $3 million gain, there is no tax at the entity level. The full $5 million can pass through to the owners who pay their pro rata share of the $3 million gain. If you think C corporation treatment is better because the entity pays the tax, think again.

After all, when shareholders of a C corporation receive distributions from the corporation, they too must pay tax at their individual rates. Of the $3,905,000 distributed to them, how much tax they pay depends on their basis in their shares and other variables. But they pay two levels of tax. The partners of a partnership or members of an LLC are better off because they only pay one level of tax, not two.

There is only one level of tax if the business owners sell their interests in a corporation, partnership or LLC. To determine whether there is gain or loss and how much, you'll need to know the owner's basis in the ownership interest. With an LLC or partnership, this is sometimes referred to as "inside basis," to distinguish it from the "outside" basis that the entity has in its assets.

For more see:

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