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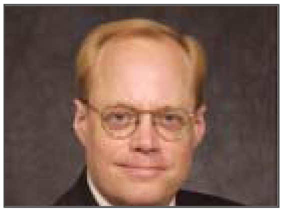


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# Merck Or Mom & Pop, Taxes Control Business Sales

Business owners often talk of selling to retire, move away, capitalize on a hot market or just do something else. Sales of small businesses are up, and sales mean taxes. Big or small, if you have a business, taxes influence—and often control—how you sell. That's so whether you are Merck selling its consumer care business to Bayer AG for $14.2 billion, or a mom and pop business

You may be talking about a home-based internet business producing $20,000 a year. Perhaps a huge conglomerate producing $20 billion. Business sales are surprisingly consistent in concept, documentation, legal and tax rules across a wide spectrum of size and type. And taxes are inevitable.

First, consider the type of business entity being sold. If you operate a proprietorship, partnership, or limited liability company (LLC), you should generally be able to sell your business with a single level of tax. If you invested $20,000 to start your proprietorship or LLC business and later sell it for $50,000, your gain of $30,000 is taxed at your personal tax rate. The result is similar if that is your share of the sale of a partnership or LLC business.


Partnerships and LLCs are tax reporting entities but generally don't pay taxes. The individual partners—or in the case of LLCs "members"—pay tax on their percentage portion of the profits. A sale of a partnership or LLC business involves these same rules, so usually only one tax is collected at the partner/member level.

There is only one level of tax if the business owners sell their interests in a corporation, partnership or LLC. To determine gain or loss, 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 the entity has in its assets

If the business is a corporation, the tax rules are more complex. Most corporations are "C corporations," meaning the corporation did not file an S election. "S corporations" are generally taxed more like partnerships. C corporations are taxed on their own income at a corporate tax rate. Corporate distributions are then subject to a second tax to individual shareholders.

This fundamental feature of the corporate tax law is what drives how businesses are sold. Buyers inevitably want to buy the assets of a corporate business not its stock for two reasons. First, buying the stock incurs true successor liability for every past corporate liability. Buyers are able to avoid many target company liabilities by buying the assets and leaving the corporate shell.

Second, buyers want to buy assets because they get a new tax basis in the assets. A higher basis means higher depreciation deductions in the future. In contrast, if the buyer bought the stock, it can't depreciate it and would generally be stuck with the low asset basis locked inside the company.

Sellers, on the other hand, prefer to sell stock, not assets. The reason is taxes. If a C corporation sells its assets and then distributes the sales proceeds to shareholders, the combined corporate and shareholder tax rate exceeds 50%. That hurts. A shareholder sale of stock might incur one tax as low as 15%, but probably never higher than 23.8%%.

Knowing this universal dynamic can help you plan ahead. If you have a C corporation and wait until you are ready to sell your business to discover these sale rules, you'll be sorry. Although you may be able to orchestrate a tax-free deal, there's usually a high price for such arrangements. Plus, you dramatically limit the buyers that can qualify.

So plan ahead and consider your business structure years before you want to sell. You can probably produce a far more efficient tax result later when you sell.

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