



For Biz-Owning Clients, Good Time To Sell But Bad Time For Taxes

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The demographics of retiring baby boomers and the waning of Covid-19's economic ravages likely mean business owners will think more of selling their companies in the coming months—even as proposed hikes in capital gains and other tax proposals may soon affect those sales. Wealthy biz-owning clients have a lot to think about.

"It's very likely that there will be changes to capital gains rates and that the highest rate will increase in 2022," said attorney Robert C. Creighton, managing partner at New York law firm Farrell Fritz. "This reality has caused business owners who are considering the sale of their business to seek to get transactions done this year so that their gains will be taxed at current rates."

"We've seen that many business owners see buyers, both financial and strategic, in the market with significant money to spend," added Jose Reynoso, director of advanced tax and estate planning at Clarfeld Citizens Private Wealth in Tarrytown, N.Y. "They recognize that we may be at the end of an economic cycle after going through the stress of a pandemic."

Proposed tax changes are dampening sellers' enthusiasm. Earlier this year, the proposed highest capital gains rates were to go from 20% to 40% for those with income above \$1 million. Recent draft legislation proposes a 25% cap gains rate for those with income greater than \$400,000 or \$450,000, depending on tax-filing status.

"The Biden proposed tax increase on capital gains is, in my opinion, a tax on success," said Craig J. Ferrantino, founder and principal of Craig James Financial in Melville, N.Y. "The way the American capital gains tax system is set up, you risk your capital and hard work, and if you are successful and you sell your business you'll be taxed on that success. Raising the capital gains rate for some earners to the ordinary income rate ... could encourage owners not to grow their business and prevent future growth in the economy."

"Business owners who were considering selling are likely relieved that the rate is 25%, versus 40%," said Mallon FitzPatrick, managing director and principal at Robertson

Stephens Wealth Management. The top income tax rate is also proposed to increase, he added, potentially further motivating biz sales this year, if possible.

Starting in 2022, business profits from S corporations will also incur a 3.8% net investment income surtax for high-income taxpayers. "S corp owners who sell before year-end would avoid this surtax," FitzPatrick said.

Other, less obvious potential changes to estate tax laws might fuel sales this year as well, Creighton added.

Reynoso said a recent survey by his company showed that two-thirds of high-net-worth and ultra-high-net-worth business owners accelerated plans to sell their businesses because of the pandemic. "Even those who didn't sell their business made significant changes," he said, adding that 65% of the wealthy and ultra-wealthy business owners moved their business since March 2020, often to lower-tax states.

Ferrantino's clients are also concerned about the repeal of the stepped-up cost basis rule. In his area, farms purchased 60 years ago for five figures may be worth tens of millions of dollars today. The next generation that inherits such an asset, which doesn't produce enough to pay such a hefty tax bill, would have to sell on inheritance.

So what advice is there for clients who won't be ready to sell for a year or two? "We've recommended charitable solutions such as charitable remainders trusts and charitable lead trusts," FitzPatrick said. "An installment sale is another possibility. If the buyer's open to it, the sale can run over multiple years to help spread the realization of gain."

Even though the clock is ticking this year, "owners are generally more concerned about the terms of the sale itself rather than the changes in tax implications," FitzPatrick said. "Clients view finding the right buyer and obtaining the most favorable terms as more important than the current political backdrop, especially when the legislation hasn't yet been finalized."

Still, Creighton added, "depending on the size of the business, the window is rapidly closing to get a deal done in 2021."