How to Shift Corporate Ownership and Save on Taxes

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It pays to plan ahead in almost any situation in life, and the future of your corporation is no different. You have multiple options for what to do with your business when you’re ready to step aside, but we’re going to focus on one in particular that provides you with a nice tax-saving strategy. In a private letter ruling, one man who owned 100 percent of his company’s stock was able to gift some of his stock to his children and then sold the rest to his corporation.[1] The great news is you can use the strategy with anyone—not just your kids.

Here’s how it worked for him:

- He had a third-party appraiser determine the per-share value of the corporation.
- His two children wanted to own and run the company, so he gifted shares to each of them.
- Right after that, the corporation redeemed the remaining stock, providing the man with cash and a promissory note. This last move is important because it means that the children then owned 100 percent of the corporation and the father had the promise of future payments, as well as immediate cash.

What It Means in Terms of Taxes

In a situation like the one above, the recipients are not subject to any taxes for the gifts. The previous owner may be subject to taxes, depending upon how much each of the shares was worth. You pay no gift taxes for amounts less than $14,000 in 2014.[2] Anything over that amount dips into your estate tax and lifetime gift tax exemptions.[3]

Now, another thing to consider is *how* you will be taxed. You want to be taxed at the tax-favored capital gains rate for selling the stock to your corporation. In order to make this happen, you’ll need to file the right IRS-required elections for complete termination, as well as those that will allow you to avoid stock attribution rules on the shares given to the gift recipient(s).[4]

Without the termination election, you will be subject to taxes at the dividend rate, and you would receive no offset for your basis. Capital gains, on the other hand, are offset by your basis so that you are only taxed on the net gain. In addition, the cash plus promissory note combination is an installment sale, meaning the taxes will be paid on the cash only in the first year, and then tax payments will be made each year after that on the gains and interest received. As for the corporation itself, it will be able to deduct the interest it pays on the

promissory note.

Of course, you should check the applicable mid-term minimum federal interest rates for such situations.[5] These rates can be used for your calculations when planning your retirement strategy. Also, you'll want to use appropriate rates when you establish the promissory note.

In summary, by using this particular strategy for shifting corporate ownership, you'll get up-front cash, interest on the promissory note, and tax-favored capital gains treatment on taxes. The recipient or recipients of your business have no tax burden on the transaction, and the corporation gets to deduct the interest payments made to you on the promissory note. This strategy works well if, like the man in the private letter ruling, you plan to transfer your corporation to your children. But, it works just as well for transferring the company to an employee, colleague, or current shareholder. Exiting your business should be planned just as carefully as every other decision you have made along the way.

1. Private Letter Ruling 201228012 ^
2. IRC Section 2503(b); Tax Foundation ^
3. IRC Section 2010(c)(3); Tax Foundation ^
4. IRC Section 302(c)(2)(A)(iii) as specified by Reg. Section 1.302-4(a) ^
5. http://apps.irs.gov/app/picklist/list/federalRates.html ^