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ARM Intel

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Capital Gains Tax Increase: Implications to Consider

Owners of ARM (and other) firms may want to consider the timing of a potential sale of their company before the calendar flips to 2011. With the long term federal capital gains ("LTFCG") tax set to increase from 15% to 20% next year, the timing of a sale will have a significant impact on a seller's "net" from a transaction. This is because the Bush era LTFCG tax cut, which lowered the rate to 15%, is set to expire after 2010. Barring further legislation, the rate will likely revert to 20%, which is what it was prior to the tax cut.

	Current tax	Same price, higher tax, lower net	Higher price and tax, same net
	2010	2011	2011
Sale Consideration	$ 10,000,000	$ 10,000,000	$ 10,625,000
Less: LTFCG Tax	(1,500,000)	(2,000,000)	(2,125,000)
Net Proceeds after LTFCG Tax	$ 8,500,000	$ 8,000,000	$ 8,500,000
LTFCG Tax %	15%	20%	20%

To understand the impact of this tax increase in concrete terms, let's do some quick math. Assume you're a business owner and you've received an offer of $10 million to sell your company. Let's also assume you've owned your company for over one year. If you sell for $10 million before December 31, 2010, you likely owe Uncle Sam $1.5 million for the pleasure of selling your shares and rewarding yourself for all of that hard work over the years.

Now, let's assume you hold out for a better offer. After all, 2010 is going well for many ARM firms, so it may seem attractive to wait until 2011. If you sell in 2011 for that same $10 million, however, you would owe the tax man $2 million, or $500,000 more. As the chart above indicates, in order to net the same after tax amount in 2011, you would need to receive purchase price consideration of at least $10.625 million, an increase of 6.25%.

We're not saying that everyone should sell today. For some, there are legitimate reasons not to sell. We're merely pointing out some of the things to factor into any discussion about the timing of a sale. The chart at right includes a handful of other potential risks to ARM firms that can have a significant impact on this decision. After all, in the final analysis, we all want to make informed decisions.

When considering the timing of a potential sale of your ARM firm, we'd encourage you to take into account the appropriate factors, which go well beyond the commonly discussed purchase price or "multiples". Taxes are certainly one key consideration, and the impending tax change is significant. Taking a comprehensive view on this topic, we have advised clients with strategies to help them capitalize on the current market with regard to advantageous deal structures, M&A trends, lending based on specific types of ARM services, pre-M&A preparation and other critical items to help maximize shareholder value in a transaction. If you would like to discuss today's market in relation to your firm and your plans, please feel free to contact us.

Additional Risks to Consider

- You may not receive a better offer in the future.
- Business risks in ARM firms can include loss of a major client, loss of key staff, decreasing liquidation rates, regulatory changes, etc.
- Economic risks can include adverse changes in the financing market for M&A transactions, declines in purchase price multiples, etc.
- The LTFCG tax could actually revert to higher than 20%, as the federal government looks for ways to counter its staggering deficits.

Disclaimer: This article, which addresses only LTFCG tax, is not intended as or to be used as definitive tax advice. Always consult with an experienced tax advisor to understand all of the current laws specifically associated with each situation.

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