

ADVICE/NEWS

# Should you sell your S-Corporation?

Should you sell for S-Corporation in 2010? Maybe so. Here's why. On Feb. 17, 2009, President Obama signed the American Recovery and Reinvestment Act (The Recovery Act). An interesting and somewhat strange provision was included which shortens the built-in-gain recognition for S-Corporations for taxable years 2009 and 2010. This creates an opportunity for business owners to sell in 2010 and not be subject to taxes on the related gains.

## The Background

In general, S-Corporations are similar to partnerships in the sense that they normally do not pay any income tax. Instead the income or loss is passed through to the shareholders who report the S-Corporation net income or loss on their individual returns.

However, S-Corporations do pay tax under certain circumstances. This occurs when a C-Corporation elects to be taxed as an S-Corporation. This election is frequently made by owners who anticipate a sale at a point in the long term future that will enable them to save on taxes. Once an S election has been made, the S-Corporation has to wait 10 years to avoid paying built-in gains tax on appreciated assets at the time of conversion. If the S-Corporation were sold before the 10 year period was up, the gain would be taxed at 35 percent - a pretty steep price to pay by the corporation. The distributions to the shareholders would also be taxed at shareholder rates. If this



## Guest Column

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double tax - tax to the corporation and tax to the shareholders - can be avoided, it could save a considerable amount of money.

### The Opportunity

The new Recovery Act legislation temporarily shortens the reorganization period from 10 years to seven years. For S-Corporations, if the seventh year precedes their 2009 and 2010 tax years, no built-in gains tax will be imposed. Therefore, for S-Corporations who made their elections in 2002 or 2003, there will be no built in gains tax at the S-Corporation level if they sell in 2010.

### An Example

To illustrate this, we must start out with the fact that most smaller companies' sales are structured as an asset sale instead of a stock sale because the buyer does not want to assume prior corporate liability. The buyer will also benefit by getting a step up in basis of the assets acquired which is a more favorable tax treatment than buying stock. For our example, we then assume an asset

sale:

Company XYZ is a C-Corporation who made an election to become an S-Corporation on Jan. 1, 2003. At the time of the election, it was determined that the built-in gain amounted to \$10 million all related to goodwill of the company. In 2010, the company decided to consider selling and found a buyer willing to acquire the assets of the company for \$25 million.

If the assets are sold in 2010, the built in gains tax is zero. However, if the deal is consummated in 2011, the built in gains will be taxed at 35 percent at the S-Corporation level at a cost of \$3.5 million. In addition, the shareholder pays tax again on the flow through of the gain from the sale of the assets...a bad result.

So, if you are considering selling your S-Corporation business, or some appreciated assets and your election falls within the timelines mentioned above, think about making it happen in 2010.

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# East still is least in jobless count

BY JACK KATZANEK  
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The pattern of "east is least" continued in the Riverside County job count in March. Unemployment is still higher on the inland side of Interstate 215.

The lowest unemployment in the county was concentrated at the west end, in cities such as Murrieta at 10.1 percent, Temecula at 10.4 percent and Corona at 11.3 percent. The lowest jobless level of any area in the county, excluding the desert areas where retirees predominate, was Woodcrest, an unincorporated area near Riverside that had only 9.6 percent.

The story changes in cities to the east. Banning and Beaumont are both at 17.2 percent. Hemet came in at 18.9 percent and San Jacinto at 22.4 percent. The worst unemployment in all of Riverside County was Cabazon at 35.3 percent, but the worst situation is probably the combination of two fairly large population centers: Moreno Valley (17.4 percent) and Perris (23 percent.)

The state Employment Development Department computes unemployment based on where you live, not where you work or used to work, and the higher rate in eastern Riverside County has a little to do with the pattern of commuting.

A lot of residents of Corona work in Orange County, and many Temecula people drive to the San Diego area. So the jobless rates reflect some of the economic conditions outside Riverside County.



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