C Corporations: What a Sale Looks Like Under Current vs. Proposed Tax Law

For owners of C Corporations[1] who are considering a sale, timing is everything—especially in an election year. Recent proposals suggest that the corporate tax rate[2] be increased from 21% to 28% and that the favorable long-term capital gains rate be increased from 20% to 39.6% for high-income taxpayers[3].

This could have significant tax implications for owners of C Corps. As a separate taxable entity, a C Corp that generates a profit incurs a tax on that profit. If the C Corp then pays a dividend to the shareholder, as in the sale of the business, the dividend is also subject to income tax at the shareholder level.

So what would the picture look like if a business were to be sold under current and proposed law?

C Corp Stock Sale

Selling a business in a stock transaction that realizes long-term capital gains of $25 million under current tax law would generate a capital gains tax of $5.95 million vs. $10.85 million under the proposed legislation, which is about an 80% tax increase. The seller would receive net proceeds of $19 million vs $14.15 million, a $4.9 million difference. See Exhibit 1.

Exhibit 1: C Corporations Stock Sale

	Current Law	Proposal
Sale Price Gain	$25M	$25M
Capital Gain Tax[4,5]	$5.95M	$10.85M
Net Proceeds to Seller	$19.05M	$14.15M
Difference	**$4.9M**	

As illustrated in Exhibit 1, there is more than a 25% reduction in after-tax proceeds.

Securities

Assume the assets of the company are valued at $30M[6,7] with a cost basis of $12.5M. Under current legislation, there would be an entity-level gain of $17.5 million. The corporate tax at 21% would be $3.67M. The remaining proceeds of $26.3M in cash as a liquidating dividend would be taxed at 23.8% or $6.27M. The seller would net $20M. Under the proposal, the entity tax would be $4.9M at 28%, and the dividend tax would be $10.9 million at 43.4%, netting the seller $14.2 million.

Exhibit 2: Asset Sale

	Current Law	Proposal
Sale Price of Assets	$30M	$30M
Cost Basis	$12.5M	$12.5M
Corporate Level Tax	$3.67M	$4.9M
Dividend/Capital Gain Tax	$6.27M	$10.9M
Net Proceeds	$20M	$14.2M
Difference	**$5.8M**	

As illustrated in Exhibit 2, that is a 29% reduction in after-tax proceeds.

Summary

We cannot predict if and when any of these proposals will be enacted or what variations or modifications to rates, brackets, credits, deductions or incentives would be included. That said, it may be helpful to look at the possible impact on business net profit or net proceeds from a sale.

If your business is in a position to be sold, current economic and market conditions may make this a more favorable time. Work with BNY Mellon Wealth Management to guide you and ensure optimal results.

[1] C Corp files IRS Form 1120 and are taxed at the entity level. The SBA reports that C Corps are the legal form for 25% of small businesses.

[2] The corporate tax accounted for 6.6% of total Federal revenue in 2019 at $230 billion. Roughly 44 states impose a corporate income tax, but for simplicity of illustration, no state tax is assumed.

[3] Vice-President Biden has proposed tax increases both on C Corps(1) and on individuals. Some of the basic provisions are as follows:

- Increase in the highest individual tax rate from 37% to 39.6% (the top rate in 2017) for taxpayers earning more than $400,000.
- Increase in the tax on long term capital gain and dividends from 20% to 39.6 (23.8% to 43.4%), including NII for income above $1 million.
- Increase in the corporate tax rate from 21% to 28% and reinstate a 15% minimum book tax. There would also be an increase in the tax rate on foreign profits.

[4] Certain taxpayers are subject to an additional 3.8% tax on net investment income (NII) if not actively involved in a trade or business. The combined NII and the highest Federal long term capital gain rate is 23.8%.

[5] Certain sellers of C Corps may exempt gains of $10 million or more if qualified small business under IRS sec 1202

[6] 20% premium for assets sale assumed as the buyer of assets can write off the cost of the assets over time while in a stock sale there is transferee basis to the buyer.

[7] Many transactions are structured as stock sales but treated as asset sales for federal tax under section 338(h) (10)

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