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Save On Taxes When Selling a Business

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Save On Taxes When Selling a Business
Making the most of the capital gains exemption means significant savings

In the many conversations I have with owners of private businesses who are thinking of a succession plan or selling the shares of the company, I am constantly surprised they are virtually unaware of the tax benefits. In the 2007 federal budget, the lifetime capital gains exemption was hiked by 50% to $750,000. This means the first $750,000 of the sale price of each shareholder's company shares will have a capital gains exemption from all income taxes. Under our Canadian tax laws, taxpayers bring only 50% of the remaining gain into play as income and pay taxes only at their individual marginal tax rate.

In addition, there are some intriguing ways to further maximize the net gains in situations when a couple wants to pass on their business to their children.

Under an estate freeze (a method of fixing the value of your business and passing future growth on to beneficiaries), parents exchange their common shares in the enterprise for preferred shares frozen at the current value of their business. Let's say the value is $4 million. This means that the business's future growth will flow to newly created common shares held in the trust that names the children as beneficiaries, and only the children will benefit from future growth and capital gain.

Sometime in the future when the parents decide to sell the business for $7 million, the family trust would designate the capital gain to the children as named beneficiaries. If there were three offspring, each would receive $1 million. When each child claims their capital gains exemption of $750,000, they would be liable to pay taxes on only $250,000 each. The marginal tax rate for each child would, of course, depend on each person's individual situation. In effect, we create five different capital gains exemptions instead of the original two, which acts to considerably lower the tax liability.

Often when a business owner sells, part or most of the purchase price is paid out over an extended period of time. He or she then has an opportunity to spread or defer the capital gains over several years. So if the balance of the purchase price is doled out in periodic payments, it's recommended a maximum 20% be paid each year for a period of five years.

Now, if someone has already cashed in some of the entire previous capital gains exemption limit of $500,000, the $750,000 new limit would be reduced.

To qualify for these exemptions, certain criteria must be met:

1. Taxpayers must have owned the company more than 24 months before the sale. This is known as the holding period.

2. During the holding period, the business must have used more than half of the enterprise's assets at current fair market value.

3. On the actual date of sale, the enterprise must have been using more than 90% of these assets.

There can be other complications. If a Canadian company has an asset in the form of an American subsidiary, the U.S. asset would not be included in calculating the capital gains and the exemption totals. So, it would be best to separate the two assets to be two separate entities.

How much can a seller save? It all depends on where he or she resides and their own marginal tax rate, but the exemption can convert into significant savings.

If you found this information useful and you'd like to find out more about how we can help you sell your business for maximum value, please call us on 1-780-469-4769. You can also email us at info@vralta.com or visit our website at www.vralta.com.

About Us

VR Business Sales has attained the position as Alberta's market leader in the sale of privately owned companies. Our clients choose us because, through our proprietary marketing process, we are able to sell small and mid size businesses for its maximum value than are typically achieved. Since 1979, VR has built up a reputation based on trust, integrity and mutual respect.

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