

If you're a business owner in the process of selling your business, you're probably worried about the impact of capital gains tax that you may incur. Planning the sale of your business should occur years in advance with the help of your financial services professional and tax and legal advisors. The earlier you plan, the better, to minimize capital gains.

To minimize the capital gains tax, there are several strategies to consider. Some of these strategies have existed for many years and are regularly used, while others are legislative solutions that were recently enhanced by the One Big Beautiful Bill Act (OBBBA) signed by President Donald Trump on July 4, 2025. We'll review a few strategies, but you should consult with your tax and legal advisor for further guidance.

#### **Installment Sales**

An installment sale is a common method to sell a business. Typically, your buyer might not have sufficient funds to pay the sales price in full and must spread out the payments over several years. These installment payments, and the taxation of them, are governed by IRC Section 453 which requires that at least one installment payment be made after the close of the taxable year in which the disposition occurs.

Each payment consists of interest income, return of adjusted basis, and gain. Therefore, gain is spread over the installment payment period allowing the seller to absorb the capital gains tax burden over time. The interest rate used must be "adequate," which typically means that the rate is at least as high as the applicable federal rate (as published by the Internal Revenue Service) at the time of the transaction.

An installment sale cannot be used for the sale of inventory or publicly traded stock. It also cannot be used for a sale at a loss. Installment sales to family members or controlled entities are scrutinized and may be subject to immediate realization of gains if the business is resold within two years. Prepayments, the sale of depreciable property, and payment defaults add significant complexity to the taxation of the amounts received.

Some downsides to this strategy include: **a)** whether your buyer can generate enough business income to maintain the installment payments and pay him or herself sufficient income; **b)** economic downturns or other catastrophes impacting the continuing success of the business; and **c)** you have to wait for your money and many unforeseen events may occur during that time.

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Some transactions include having a fully funded buy-sell agreement in place using life and disability buyout insurance and recapture clauses upon default. Liens may be placed on business assets or property. You may also purchase life insurance on the buyer once the transaction has been completed to ensure payments. If you remain as an employee or consultant to the business, the buyer may even want to purchase key person insurance on your life.

# **Charitably Inclined Sellers**

If you're charitably inclined, you may gift a business interest to a charitable remainder trust (CRT), generating an income tax deduction as well as a stream of income for a period of years up to 20 years, or for life. The CRT will sell the business and reinvest the proceeds in order to have sufficient liquidity to pay the income stream. The CRT is tax-exempt and pays no capital gains tax on the sale. At the end of the income term, the assets remaining in the CRT will go to your designated charity.

Generally, the income stream paid to you will be taxed on a four-tier system and in this order: **a**) ordinary income; **b**) capital gains; **c**) other income (e.g., tax-free income); and **d**) return of principal. Therefore, capital gains on the sale of the business are minimized but not completely eliminated.

There must not be a "prearrangement" for the sale of the business by the CRT prior to contributing it to the CRT. What constitutes a prearrangement is determined based on a facts-and-circumstances test but the consequences may be the immediate recognition and taxation of gain.

There are other limits to this strategy. It works primarily for businesses operated as C corporations because a CRT is not an authorized S corporation shareholder, and pass-through entities may cause unrelated business taxable income which may result in an excise tax. Businesses with outstanding loans are problematic because they may cause the CRT to lose its tax-exempt status.

The income stream from the CRT can be used for retirement income purposes. It may also be used to fund life insurance premiums to replace the amounts given to charity and to create an income tax-free bequest to family members.

### **Qualified Small Business Stock**

If you're a C corporation business owner, you may have some or all of the gains excluded from income when that stock is later sold, provided the stock was acquired directly from the corporation and not from a resale or secondary market. That's known as qualified small business stock (QSBS) authorized by IRC Section 1202 (aka "Section 1202 stock"). The QSBS strategy has become more popular in recent years because the Tax Cuts and Jobs Act of 2017 (TCJA) instituted a flat 21% corporate income tax bracket. This made the formation of new businesses as C corporations more attractive, compared to pass-through entities (e.g., partnerships, S corporations or limited liability companies) which pass through income to the individual owner at individual income tax rates. Forming businesses as pass-through entities has been very common over the last couple of decades.

Only C corporations in certain industries qualify for QSBS treatment. Corporations must also have assets of less than \$75 million (raised from \$50 million as a result of the OBBBA). At least 80% of those assets must be used in an active qualified business. For stock held for at least 3 years, 50% of the gain may be excluded when the stock is sold. For stock held for at least 4 years, there is a 75% exclusion and for stock held 5 or more years, 100% of the gain may be excluded. The further limitation is that the exclusion is limited to \$15 million (increased from \$10 million by the OBBBA) or 10 times the basis of the stock sold, whichever is greater.

However, many small businesses are sold as an asset sale, rather than a stock sale, because buyers do not want the possible hidden liabilities associated with stock. Doing so eliminates the possibility of using the QSBS strategy.

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## **Qualified Opportunity Zones**

The TJCA provided investors and business owners an opportunity to defer taxes on capital gains when they sold their investments, provided that the proceeds were reinvested in funds created to benefit lowincome areas designated by the governors of each state and certified by the U.S. Dept. of Treasury. These areas are known as Qualified Opportunity Zones (QOZs) and the funds are Qualified Opportunity Funds (QOFs).

Under the TCJA, deferral of gains were allowed until Dec. 31, 2026, if the reinvestment into a QOF occurred within 180 days. Partners in a partnership, shareholders of an S corporation, and beneficiaries of estates and non-grantor trusts had the option to start the 180-day investment period on the due date of the entity's tax return, not including any extensions. Depending upon how long the funds were held in the QOF, potentially some or all of the deferred gain could be excluded from income. If the QOF investment is held for at least 10 years, the basis in the investment is "stepped up" to fair market value at the time of sale, eliminating capital gains tax.

This strategy was supposed to sunset at the end of 2026. The OBBBA permanently extended QOZs by allowing governors to designate new QOZs every ten years starting in 2026, although the rules governing what constitutes low-income areas were tightened. Also, the rules governing exclusion of gains were changed with new investments into QOFs starting in 2027.

If you don't need some or all of the business sales proceeds for retirement or other uses for at least 10 years, this might be an excellent strategy for you.

This is a brief summary of a few strategies that may help you, as a business owner, to minimize or avoid capital gains taxes upon the sale of your business. There may be other appropriate strategies. Of course, you must consult with your individual tax and legal advisor to ensure that the strategy is appropriate for you.

#### For More Information Contact:

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