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Politics and Taxes

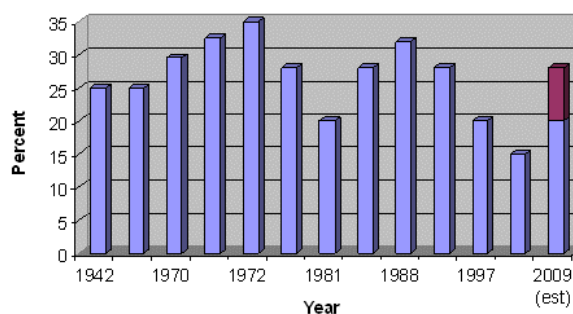
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In this world, nothing is for certain but death and taxes, and taxes are definitely unavoidable and significant in the sale of a business. While careful strategic planning between the owner and his attorney, accountant, financial planner and business intermediary can reduce the tax consequences after the sale, the government will inevitably claim its portion of the transaction. For the last five years, business owners have enjoyed the lowest capital gains rate since the early 1930s and a reduced income tax rate. However, President Obama may cause that to change.

History

In 2003, President Bush, in reaction to the dampening economy, urged the United States Senate to pass the Jobs and Growth Tax Relief Reconciliation Act of 2003. Designed at stimulating the economy and creating jobs, this \$350 billion tax package specified a series of provisions for reducing tax rates and increasing tax deductions. For business owners, the most significant clauses were the reduced income tax for the top two brackets (from 35 and 38.6 percent to 33 and 35 percent respectively) and lowering the federal capital gains tax rate to the historic low of 15 percent. When the capital gains tax rate was reduced in 1997 and again in 2003, Congress chose not to apply those changes retroactively for the entire year, though they do have the authority to do so. This bodes well for future legislation that is anticipated to take place at the end of 2010.

Historic Individual Capital Gains Tax Rate



Future Outlook

Currently, the tax law is set where in 2011 the capital gains tax rate will automatically increase from 15% to 20%. President Obama stance is that he does not see any need to change this increase for most taxpayers. In President Obama's budget, proposed in 2009, there would be a complete exemption of the capital gains tax on qualified small business stock after February 17, 2009 and held for five years. Recently President Obama has suggested the elimination of the capital gains tax on small investment for one year, which Congress promptly suggested more than doubling the tax rate from 15% to 35%. This rate increase would be applicable to venture capitalists investing in start-up companies. It may also be applicable to some private equity firms, real estate firms, and oil and gas partnerships.

Estate Taxes

Another political tax issue that must be addressed is that of the estate tax. The recent history of the estate tax dates back to George W. Bush in 2001 when he cut the estate tax from 55% to 45% with the estate tax going to zero in 2010 then reverting back to 55% in 2011. Currently the exemption level for this tax is at \$3.5 million, which means that this will not affect the majority of Americans.

The future of the estate tax is uncertain. President Obama has made it clear that he does not want the estate tax to go to zero in 2010, which is evidenced by the footnote on page 127 of the President's budget that reads "The estate tax is maintained at its 2009 parameters"¹. This means that the estate tax would remain at the 45% rate through 2010 until it reverts back to 55% in 2011.

Legislation has yet to be passed to make sure the estate tax does not go to zero next year; however, numerous bills have been proposed. On January 9, 2009 the "Certain Estate Tax Relief Act of 2009" was introduced, which proposed freezing the maximum estate tax rate at 45% as well as the current exemption amount of \$3.5 million. Other proposed pieces of legislation have suggested reducing the exemption amount to \$2 million as well as increasing the exemption amount to \$4 or \$5 million, while others have proposed varying the estate tax rates from 35% to 55%.

Conclusion

As it stands, the capital gains tax rate is still in a state of flux. The current capital gains tax rate of 15% ends January 1, 2011, and will automatically revert back to the 20% rate it was at. President Obama suggested having this rate change to 20% in 2010 in the budget proposed earlier in the year, however, this remains to be seen.

Just like the capital gains tax rate, the future of the estate tax rate and exemption amount is still unknown. Based on the indications by President Obama and Congress, the estate tax rate will not go to zero in 2010; however, what it will change to remains to be seen. Business owners considering the potential sale of their businesses may want to plan ahead and discuss their options with a business intermediary today.

Disclaimer: The above information is for informational purposes only and is not meant to be used in lieu of expert tax advice. Consult with a tax expert for advice about estate planning and taxes.

¹ Wall Street Journal. "Night of the Living Death Tax". March 31, 2009.
<http://online.wsj.com/article/SB123846422014872229.html>