C Corps—A Lay Person's Pitch to Looking Ahead.

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I'm an attorney by background so I'll start in typical attorney fashion with a disclaimer. Boring I know, but important to know from where this comes. I am not an accountant or tax expert. Frankly, I'm not even a tax amateur. What I am, however, is a business broker who works with owners ready to transition to their next step and I see these issues on the front lines.

A near selling time scenario: Many big pieces are coming in place. Excellent, desirable practice. Interested and qualified buyer. Financing—check. Details of the transition—check. But a big hurdle remains: Your practice's C Corp status. What's the big deal, you ask? With a C Corp, there can be large corporate taxes due upon sale. Because of this, there can be serious hang ups surrounding how the sale should be structured.

Stock Sale, Why It Won't Work:

One way sellers' advisors try to work around the C Corp tax issue is to push for a stock sale, instead of an asset sale.

Here's the problem: Finance companies 99% of the time will not lend on practices with a stock sale (partial associate sale is different situation). Lenders are just not willing to work with the potential liability impediments that can come with a stock sale. Sellers' advisors want to combat this liability through legal protections. Unfortunately, most of the lenders (read almost all lenders) still won't lend on a stock sale; even despite good ideas and legal protections. The bank calls the shots. A stock sale will be a no-go.

A Good Concept With Mixed Results; Personal vs. Corporate Goodwill:

Some accountants work with allocating part of the practice price between personal and corporate goodwill. The idea is that personal goodwill is taxed lower at capital gains vs. the much higher corporate rate. This approach makes a lot of sense to me; part of the practice is legitimately very tied to the owner personally and part very much tied to the business itself.

There are a good many tax and legal opinions on the personal vs. corporate goodwill split with C Corps for guidance. But because there are a good many cases on this, you can gather the area is highly scrutinized (both the concept and amounts for the split). There is perhaps a certain amount of increased audit exposure.

So what's a C Corp Owner to Do? Lender (and buyer) won't go along with a stock sale. Seller's advisor may take a hard line approach and not allow a goodwill split because of potential audit and penalties (your advisor may reach a different opinion). Seller is stuck looking at ultra high taxes on a C Corp asset sale if he wants (or needs) to sell now.

The solution for me is in the now. Taxes are necessary; but being smart about it and planning ahead is essential. What if the owner had visited with his accountant years before and told her that an eventual sale would need to be an asset sale? Would the course of action have changed?

Important take a-ways:

- Have a serious in-person discussion with your accountant about your C Corporation status. Do this whether you are a new owner or if you are considering an exit in the (near) future.
- Specifically what is your benefit as a C Corp? When you sell, is there something to be gained if you were to convert to an S Corp?
- Taxes, taxes, taxes. I've heard a range of percentages here and I'm not sure the exact number matters. Bottom line—C Corp can mean MUCH higher taxes paid on a sale vs. with an S Corp or other types of entities. Perhaps there is something to your situation where the C Corp works; but it's critical to have that detailed CPA discussion.
- Only 3 years out from selling? Still worth considering. I believe there is a 10 year conversion time (C Corp to S Corp) in the IRS eyes. My understanding is that you still get the benefit for the partial time (i.e., 3 years under more favorable tax structure and then the other 7 years).
- There may be reasons why a C Corp makes sense in a certain situation. And an associate partial buy-in to a C Corp may still work (usually owner finance). (A note of caution—you might not want to bank on the associate partial sale only to have it not work and be stuck on the open market with a C Corp.) The point is to have the discussion about your best situation.

Only you and your accountant can determine your best structure. Have your decision be a conscious decision—not by default or inattention—so that it fits with where you are and where you are headed.