05-21-2018

Tax Legislation Discussion

New tax legislation could be beneficial to corporate succession planning….

While the recently passed Legislation is over 1,000 pages and many tax experts are still analyzing its full impact, it's likely the new legislation will be helpful to business owners looking to establish or amend their plans to make sure their business survives them and they enjoy some form of planned exit. Two main reasons: corporate tax rates for both C and S corporations are significantly lower and the corporate AMT has been eliminated.

Nonqualified deferred compensation (NQDC) taxation/structure has changed dramatically through the years, but its main goals of attracting/retaining key people, providing funding for key employee buyouts, providing supplemental income where limited by 401(k)s and providing real benefits in lieu of cash/stock for start-ups remain the same. As corporations do not receive a deduction for funding these plans, the lower tax rates will reduce the cost of maintaining these plans likely making more companies candidates. Coupled with the elimination of AMT, it could make funding with COLI (corporate owned life insurance) more attractive for C corporations, where insurance proceeds had previously suffered taxation. Finally, the highest corporate and personal rates have been similar in past years (39.6% vs 35%), convincing many owners to avoid such plans for

Matthew Pardieck, CFP®, CIMA®, CLU, CFC
First Vice President, Wealth Management

Christopher Corley MBA, AIF®
Financial Advisor

Ansley Mellete
Reg. Sr. Client Service Associate

28 Bridgeside Blvd, Suite 203
Mount Pleasant, SC 29464
T 843.800-3109| F 866.522.9699
www.harbourwealthmanagement.com

themselves. Thus, perhaps the most exciting part of NQDC for owners now is the ability to defer to a significantly lower bracket and build wealth through business growth or their own NQDC.

Owners can choose amongst several options on their eventual exit from the business, all with different pro's/con's: selling to an outside party, selling to select employees/family members, selling to an ESOP and gifting the business. While capital gains taxes didn't change with the new rule, owners may consider adjusting their succession plans in response to the lower corporate rates since the outcomes and comparison of alternatives will now result in different calculations—mostly for the better. For instance, "entity redemption" buy/sell agreements may be worth the simplicity versus "cross-purchase" with the reduced taxes—i.e., keeping funding within the corporation rather than with the shareholders. Interestingly, the $10,000 cap of deductions for state taxes could also make the negotiation between buyers and sellers on stock versus asset sale more interesting since asset sales will exceed this cap in almost every instance, making asset sales considerably more expensive to the seller. ESOPs retained their tax advantages, but nuances should be considered such as the potential interest deduction limitation on highly leveraged ESOPs. Finally, and promisingly, it is possible buyers will be willing to pay sellers more since the net income on businesses is likely to be higher and it's possible they themselves have more cash to fund a purchase.

Needless to say, much has changed in the tax world for business owners the past few weeks! Now more than ever, be sure to review your plans with competent tax and planning counsel.

Matthew D. Pardieck, CFP®, CIMA®, CLU®
Vice President, Investments
28 Bridgeside Boulevard, Ste. 203, Mt Pleasant, SC 29464
843-800-3109
Raymond James & Associates, Inc., member New York Stock Exchange/SIPC.