

**THINKING OF SELLING YOUR BUSINESS?  
SELLER BEWARE!**

By

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The Tax Relief Extension Act of 1999 which became effective December 17, 1999 enacted new Code Section 453(a)(2) which denies installment reporting for gains under accrual method accounting on asset (or deemed asset) sales. New Code Section 453(a)(2) drastically effects asset sales (or deemed asset sales) for deferred payments by an accrual method taxpayer. Sellers therefore should be extremely careful and aware of the risks they run of taking deferred payouts on asset sales since they may find themselves taxed with the entire deferred purchase price in the year of the sale even though the actual receipt of deferred payments may take place over months or years.

A person or entity reports on the accrual (rather than the cash) method in at least three circumstances:

1. With respect to a business utilizing inventory,
2. With respect to a business or activity electing the accrual method, or
3. Under Code Section 448 where an entity's gross receipts exceed \$5 million per year

and the entity is either a 'C' corporation or a partnership or LLC with at least one 'C' corporation equity owner.

Can the drastic effect of this new law be avoided? If the entity having the asset sale either reports on the accrual basis or utilizes inventories then the installment method of reporting will not be available regardless of other circumstances. If the entity reports on a cash basis and does not utilize an inventory then an asset sale can avoid the new law and therefore report on an installment basis if it is either (1) an 'S' corporation, or (2) a 'C' corporation with less than \$5 million in gross receipts, or (3) an LLC or partnership with less than \$5 million in gross receipts and no 'C' corporation owner.

In business acquisitions the form of the acquisition will have a significant impact. If an owner sells his stock in a corporation rather than selling the assets the installment method of reporting would still be available assuming the individual was a cash method tax payer. For example, a cash method

individual owns all the stock of a closely held accrual method corporation. This individual sells the stock for cash and a five year deferred note. The new law does not change the ability of this individual to use the installment method in reporting the gain on the sale of the stock. This is true whether or not the entity is on the accrual basis because the seller is a cash basis seller. But if the owner decided to sell the assets of the corporation (which buyers frequently prefer in order to avoid liabilities) then the entire five (5) year deferred note would be taxable in the year of the sale even though no more than 20% of the note would have been received. It becomes quickly apparent that this new law must be completely understood in connection with buying and selling businesses.

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**Ronald M. Gates** has practiced since 1973 in all phases of business and corporate law involving public and private companies. He has served as general counsel to public and private companies and financial institutions and as lead counsel in numerous mergers and acquisitions, private securities offerings, and franchise registrations. He has been recognized in the registry of business and professional leaders in the area of business law in "Who's Who Worldwide"..

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