30 Second M&A Newsletter

Biden Tax Plan Driving Business Owners to Market

During his campaign, President Biden proposed tax changes that could have a significant impact on business owners. Any business owner contemplating an exit in the next few years should consider how potential tax changes could reduce their net proceeds from a sale.

If Biden's tax plans come to fruition, the capital gains tax rate could effectively double, from 20% to 39.6% for income exceeding $1 million. Right now, that means business owners need to shift their focus from maximizing total transaction price to maximizing after-tax proceeds.

Let's assume your company sells for $10 million in today's tax environment. Under the current tax rate, you'd net about $8 million after federal taxes. The same company selling for $10 million under Biden's new tax proposal would net approximately $6 million.

Now let's say you intend to hold your company and grow it for a few more years. Suppose you grow 5% a year for the next three years for a business value of roughly $12.2 million. Selling under the proposed capital gains taxes you'll net about $7.3 million. That's a $700,000 loss in net proceeds, despite three more years of hard work. These are simplified calculations and other factors will come into play. But under our basic scenario, an owner projecting 5% annual growth would need to run the business for an additional five years to reach a breakeven point after increased capital gains.

It does seem likely the administration will focus on COVID recovery in the near-term. Some analysts suggest that new tax legislation won't pass until year-end 2021 with an effective date of 2022. That could give us a year of breathing room before new taxes go into effect.

As we know, Democrats have control of Congress. And yet, that doesn't mean tax hikes are a sure thing. With the Senate divided 50-50, and a slim margin in the House, the Democrats don't have room for dissention in the ranks. Party moderates concerned about economic recovery may push for a more tempered approach.

Business owners contemplating a sale in the next five years should meet with their advisors now and consider their exit strategies under different tax outcomes. Furthermore, business owners without immediate plans to sell should understand the potential impact of increased corporate taxes. Higher ongoing tax bills could have a material impact on an owner's wealth-building strategies and, consequently, their intentions to sell.

According to the most recent M&A Source and IBBA Market Pulse report, it takes an average of 10 months to sell a lower middle market business. If you're a business owner and you were thinking about exiting in the next couple of years, start talking to your advisors now.

Begin with an M&A advisor to get a valuation and see if it even makes sense to take your business to market. Then talk to your CPA and run the tax scenarios to understand the best- and worst-case possibilities ahead.

If predictions hold true, M&A deal teams (investment bankers, CPAs, attorneys, and lenders) could have a stressful fourth quarter in 2021 as sellers make a collective push to get deals across the finish line before year end. To my industry colleagues I say, forget those post-COVID travel plans. You're going to be busy.

To buyers who are looking at acquiring a business as a growth, diversification, or resiliency strategy, I say get your ducks in order now. Hammer out your acquisition plans, build your deal teams, and have a plan to accelerate due diligence.

Sara Burden, President
CBI, M&AMI, FMAS, FIBBA, CM&AP

678-277-9951 ext.11
sb@waldenbus.com

Learn more about Walden Businesses at www.waldenbus.com

Walden Businesses, Inc., 9040 Roswell Rd, Suite 410, Atlanta, GA 30350
Founding Member of Cornerstone International Alliance