Tax Implications of Buying / Selling Insurance Agencies

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What’s Relevant?

- EBITDA Multiplier?
  - $10 \times 500,000 = $5$ million
  - $5 \times 1$ million = $5$ million

- EBITDA Dollar Amount?
  - Who decides?

- Sales Price of Agency?

- The cash left in the seller’s pocket after all taxes have been paid.
Stock Purchase

- With a stock purchase, the buyer purchases the stock of the agency from the prior shareholder.

- Buyer has increased his basis but doesn’t get to amortize the purchase price.

- Buyer has also possibly acquired hidden or unknown liabilities.

- Seller gets to treat the gain in value as a capital gain.
With an asset purchase, the buyer purchases specific assets of the agency (such as the book of business) from the selling agency.

Buyer has purchased an asset (the book of business) that he can amortize straight-line over 15 years.

Buyer has not acquired hidden or unknown liabilities.

Seller may or may not receive capital gain treatment of the gain.
Basis

- Original cost of the property, adjusted for factors such as amortization.

- Tax is due on the gain in value of the asset.

- Most agency owners who started their agency from scratch and have not acquired agencies will have little “Basis” in their agency.
When the Seller is a “C” corporation

- Agency receives $1 million for the book of business. (Assume no basis):
  - Agency pays ordinary tax rate on the $1 million (could be as high as $340,000).
  - Assume a corporate state tax rate of 5% ($50,000).
  - Corporation has $610,000 left which it then distributes to the Shareholder.
Shareholder receives $610,000 for his stock. Again, assume no basis:

Shareholder pays capital gains tax on the $610,000, which could be as high as $122,000 (20%).

Assume a personal state tax rate of 5% ($30,500). Shareholder will also be subject to 3.8% Obamacare tax (could be as high as $23,180).

Shareholder ultimately receives $434,320. (Less than ½ the sales price!)
C Corp Asset Sale options

- Bonus all money out to shareholder
  - Subject to ordinary tax rate
  - Subject to medicare tax (2.9%)

- Take money over time
  - Still subject to double taxation

- Allocation to Personal Goodwill?
Personal Goodwill

- IRS takes a VERY CLOSE look at personal goodwill.

- Does not work if there is more than 1 shareholder and there is a shareholders agreement with non-piracy covenants.

- Does not work if agency has lots of producers.

- May work where there is a sole shareholder who built his book of business from scratch.
Assume an asset purchase for $1 million and no basis:

Agency records a $1 million capital gain. This flows onto the shareholder’s K–1 who will pay the tax.

Shareholder pays capital gains tax on the $1 million, which could be as high as $200,000 (20%).

Assume a personal state tax rate of 5% ($50,000).

Shareholder will also be subject to 3.8% Obamacare tax (could be as high as $38,000).

Shareholder has $712,000 in after tax dollars.
Converting from C corp to S corp

- **12/31/13**: Complete C corp fiscal year. Have business valued. (Assume $1 million)
- **01/01/14**: Effective Date of S Status
- **12/31/14**: End first year as an S corp
- **03/15/14**: Last date to elect S Status.
- **03/15/15**: File first 1120S and indicate value
Converts from C corp to S corp

01/01/14
Business is valued at $1 million

01/01/24
Fully treated as an S corp

01/01/14 – 12/31/23
First $1 million treated as a C corp and will be subject to the built in gains tax at a flat 35%, anything over that treated as an S corporation.
Federal Taxes

Capital Gains Tax Rate

Income < $450,000
($400,000 if single)
• 15%

Income > $450,000
($400,000 if single)
• 20%

Capital Gains Tax to pay for National Healthcare

Income < $250,000
($200,000 if single)
• 0%

Income > $250,000
($200,000 if single)
• 3.8%
Payment of Taxes

**Lump Sum**
- Pay all taxes in the year the business is sold

**Installment**
- Pay taxes as you receive payment (cannot be family if asset purchase)
When to Take the Money?
(Assume $200,000 of other Modified AGI annually and filing single)

- $1 Million cash up front?
  - $180,000 in capital gains tax ($600,000 @ 20% + $400,000 @ 15%)
  - Capital gain tax of $218,000

- Two annual payments of $500,000 each?
  - $90,000 in capital gains tax ($300,000 @ 20% + $200,000 @ 15%) (YR1)
  - $90,000 in capital gains tax ($300,000 @ 20% + $200,000 @ 15%) (YR2)
  - Capital gain tax of $199,000

- Four annual payments of $250,000 each?
  - $40,000 in capital gains tax ($50,000 @ 20% + $200,000 @ 15%) (YR1)
  - $40,000 in capital gains tax ($50,000 @ 20% + $200,000 @ 15%) (YR2)
  - $40,000 in capital gains tax ($50,000 @ 20% + $200,000 @ 15%) (YR3)
  - $40,000 in capital gains tax ($50,000 @ 20% + $200,000 @ 15%) (YR4)
  - Capital gain tax of $160,000

- Don’t forget about the Obamacare Tax!
Allocation of Sales Price

- Expirations
- Price Allocation
- Goodwill
- Furniture
- Non-Compete
## Buyer vs. Seller

<table>
<thead>
<tr>
<th>Category</th>
<th>Buyer</th>
<th>Seller</th>
</tr>
</thead>
<tbody>
<tr>
<td>Furniture &amp; Fixtures</td>
<td>Gets to depreciate it more quickly than 15 years</td>
<td>May have a recapture of depreciation (which is ordinary income) depending on remaining basis in the furniture.</td>
</tr>
<tr>
<td>Non-Compete</td>
<td>Buyer must amortize over 15 years even if Agreement is for less than 15 years</td>
<td>Ordinary income to the Seller.</td>
</tr>
<tr>
<td>Goodwill</td>
<td>Amortized over 15 years</td>
<td>Doesn’t matter to seller</td>
</tr>
<tr>
<td>Expirations &amp; renewals</td>
<td>Amortized over 15 years</td>
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</tbody>
</table>
Conclusion

- Tax implications of buying or selling an insurance agency can be very complex. Make sure you have good advisors.

- Not planning for taxes can result in the seller receiving less than 50% of the sales price.

- Tax planning should be ongoing, even if you don’t plan on selling for decades.
Questions

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