ALSTON & BIRD

WWW.ALSTON.COM

Federal Tax ADVISORY ▪

MAY 12, 2023

Common Tax Considerations When Selling a Family Business

Selling any business involves numerous tax planning considerations that will impact different stakeholders in unique ways. Selling a family-owned business is no exception, and in many ways finding the right solutions to tricky tax problems can be all the more important given the close relationships between the stakeholders.

The owners of a family business will naturally have different goals when selling the business based on their positions in the company and individual tax and income situations. One common problem is that the younger generations may want to sell all of their shares in the business while the older generations do not. Often, members of the older generation prefer to hold their interests in the business until death in hopes of obtaining a step-up in tax basis when the interests are passed on to the next generation. The opposite may also be true. At times, the younger generation may want to continue their investment in the business because they see potential growth and a solid investment opportunity under new management, whereas the older generation is looking for liquidity to enjoy retirement. There are several options for addressing these scenarios when a business is structured as a C-corporation.

One solution to these rollover issues is particularly useful when a larger company (BigCo) is interested in acquiring the business (Target). BigCo can form a new subsidiary (Acquisition Sub) and fund the acquisition by contributing cash to Acquisition Sub. Those family members who wish to continue their investment can contribute their interests in Target to Acquisition Sub in exchange for interests in Acquisition Sub. These interests can be in the form of either common or preferred stock depending on the particular family member's goals. Acquisition Sub can then buy the remaining interests in Target using the cash contributed by BigCo. This well-known and tested technique uses Section 351 of the Code to accomplish a relatively simple transaction.

Section 351 provides that taxpayers do not recognize gain or loss when they transfer property to a corporation solely in exchange for stock in that corporation and immediately thereafter are in control of the corporation. Control for this purpose is defined as owning at least 80% of the total voting power of all voting stock outstanding and at least 80% of the shares of all other classes of stock. The requirements for nonrecognition are achieved because the rollover shareholders and BigCo have both contributed property to Acquisition Sub (cash in the case of BigCo and stock in the case of the rollover shareholders); together, these parties will "control" Acquisition Sub immediately following

This advisory is published by Alston & Bird LLP to provide a summary of significant developments to our clients and friends. It is intended to be informational and does not constitute legal advice regarding any specific situation. This material may also be considered attorney advertising under court rules of certain jurisdictions.

the transaction. The shareholders who do not wish to rollover their interests will recognize gain to the extent the amount they receive in exchange for their shares exceeds their tax basis and are in no worse of a position than they would have been if the entire family had sold their shares outright.

A slightly more involved technique called the "double dummy structure" can combine two corporations, employing both Section 351 and the corporate reorganization rules under Section 368 of the Code and applicable regulations. This structure is particularly common when the acquiring company (Acquiror) is a public company and Acquiror and the target business are similar in size. The structure is often preferred in these circumstances for non-tax reasons because it can at times avoid, simplify, or delay a shareholder approval process and can be used to avoid the appearance of one large company buying out a competitor.

Mechanically, the double dummy structure requires Acquiror to form a new subsidiary (HoldCo). HoldCo next forms two subsidiaries (Merger Sub 1 and Merger Sub 2). Merger Sub 1 merges with and into Acquiror with Acquiror surviving, and the Acquiror shareholders receive HoldCo stock in exchange for their Acquiror stock. Next, Merger Sub 2 merges into the target company with the target surviving. The target shareholders receive a mix of HoldCo stock and cash in exchange for their target shares.

The double dummy structure is a useful tax planning tool because it achieves partial tax deferral for the rollover shareholders and is non-taxable to the Acquiror shareholders in many scenarios where the tax reorganization rules would be inapplicable or result in inefficiencies. The structure uses a combination of tax deferral rules under the Code to achieve tax goals for both corporations and corporate and other non-tax benefits.

Many variations on these structures can be used when selling a family business, and it is important to select the structure that will meet the tax and other needs of the family members based on their particular facts and circumstances.

For more information, please contact Jack Cummings at +1 919 862 2302 or Terence McAllister at +1 704 444 1138.

You can subscribe to future *Federal Tax* advisories and other Alston & Bird publications by completing our **publications subscription form**.

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Federal Tax Group

John F. Baron
Co-Chair
+1 704 444 1434
john.baron@alston.com

Scott Harty
Co-Chair
+1 404 881 7867
scott.harty@alston.com

George B. Abney
+1 404 881 7980
george.abney@alston.com

M. Nicole Brown
+1 404 881 7167
nicole.brown@alston.com

Andrew B. Claytor
+1 704 444 1081
andrew.claytor@alston.com

James E. Croker, Jr.
+1 202 239 3309
jim.croker@alston.com

Jasper L. Cummings, Jr.
+1 919 862 2302
jack.cummings@alston.com

John Harden
+1 404 881 7990
john.harden@alston.com

Brian D. Harvel
+1 404 881 4491
brian.harvel@alston.com

Raleigh Johnston
+1 214 922 3415
raleigh.johnston@alston.com

Jacob L. Kaplan
+1 404 881 4296
jake.kaplan@alston.com

Stefanie Kavanagh
+1 202 239 3914
stefanie.kavanagh@alston.com

Sam K. Kaywood, Jr.
+1 404 881 7481
sam.kaywood@alston.com

Clay A. Littlefield
+1 704 444 1440
clay.littlefield@alston.com

Sarah Ma
+1 202 239 3281
sarah.ma@alston.com

Terence H. McAllister
+1 704 444 1138
terence.mcallister@alston.com

Ashley B. Menser
+1 919 862 2209
ashley.menser@alston.com

Daniel M. Reach
+1 704 444 1272
danny.reach@alston.com

Heather Ripley
+1 212 210 9549
heather.ripley@alston.com

Margaret Ward Scott
+1 404 881 7962
margaret.scott@alston.com

Richard L. Slowinski
+1 202 239 3231
richard.slowinski@alston.com

Carolyn E. Smith
+1 202 239 3566
carolyn.smith@alston.com

Edward Tanenbaum
+1 212 210 9425
edward.tanenbaum@alston.com

Shawna Tunnell
+1 202 239 3040
shawna.tunnell@alston.com

Ryan Wheeler
+1 704 444 1430
ryan.wheeler@alston.com

R. Mark Williamson
+1 404 881 7993
mark.williamson@alston.com

Joon Yoo
+1 212 210 9452
joon.yoo@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

© ALSTON & BIRD LLP 2023

ATLANTA: One Atlantic Center ▪ 1201 West Peachtree Street ▪ Atlanta, Georgia, USA, 30309-3424 ▪ 404.881.7000 ▪ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ▪ Suite 21B2 ▪ No. 7 Guanghua Road ▪ Chaoyang District ▪ Beijing, 100004 CN ▪ +86.10.85927500
BRUSSELS: Rue Guimard 9 et Rue du Commerce 87 ▪ 3rd Floor ▪ 1000 Brussels ▪ Brussels, 1000, BE ▪ +32.2.550.3700 ▪ Fax: +32.2.550.3719
CHARLOTTE: One South at The Plaza ▪ 101 South Tryon Street ▪ Suite 4000 ▪ Charlotte, North Carolina, USA, 28280-4000 ▪ 704.444.1000 ▪ Fax: 704.444.1111
DALLAS: Chase Tower ▪ 2200 Ross Avenue ▪ Suite 2300 ▪ Dallas, Texas, USA, 75201 ▪ 214.922.3400 ▪ Fax: 214.922.3899
FORT WORTH: Bank of America Tower ▪ 301 Commerce ▪ Suite 3635 ▪ Fort Worth, Texas, USA, 76102 ▪ 214.922.3400 ▪ Fax: 214.922.3899
LONDON: 4th Floor ▪ Octagon Point, St. Paul's ▪ 5 Cheapside ▪ London, EC2V 6AA, UK ▪ +44.0.20.3823.2225
LOS ANGELES: 333 South Hope Street ▪ 16th Floor ▪ Los Angeles, California, USA, 90071-3004 ▪ 213.576.1000 ▪ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ▪ 15th Floor ▪ New York, New York, USA, 10016-1387 ▪ 212.210.9400 ▪ Fax: 212.210.9444
RALEIGH: 555 Fayetteville Street ▪ Suite 600 ▪ Raleigh, North Carolina, USA, 27601-3034 ▪ 919.862.2200 ▪ Fax: 919.862.2260
SAN FRANCISCO: 560 Mission Street ▪ Suite 2100 ▪ San Francisco, California, USA, 94105-0912 ▪ 415.243.1000 ▪ Fax: 415.243.1001
SILICON VALLEY: 755 Page Mill Road ▪ Building C - Suite 200 ▪ Palo Alto, California, USA 94304-1012 ▪ 650.838.2000 ▪ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ▪ 950 F Street, NW ▪ Washington, DC, USA, 20004-1404 ▪ 202.239.3300 ▪ Fax: 202.239.3333