

TAX ALERT:

For Owners of Private Security Companies



Congressional lawmakers consider rewriting the U.S. tax code for closely held businesses, including those organized as partnerships, S corporations and limited liability companies.

This could have a dramatic negative effect on the owners of these corporations as they operate the company; and on the net proceeds from an eventual sale of the operating assets.

Here's the story:

According to the "S" Corporation Association of America, about 70 % of corporations in the US have elected "S" corporation status. "S" corporations have the same advantages as traditional "C" corporations, as far as limited liability is concerned, except "S" corporations do not pay tax at the corporate level. Instead, the tax on the earnings of the "S" corporation is imposed on the shareholders - prorated based on ownership percentages.

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The purpose of making the "S" status available was to give relief to the small business owners by not taxing them in the same way the large corporations were taxed. Some of the advantages of the "S" status over the conventional "C" corporations were:

1. To obtain the limited liability protection from corporate status, while retaining a partnership type of taxation.
2. To avoid the general double tax system of "C" corporations
3. To reduce the overall income tax expense, by taxing income at a lower rate at the individual level (when applicable), than at the corporate level. Although the changes in the corporate level tax brackets over the years have sometimes resulted in lower taxes paid by traditional "C" corporations.
4. To avoid the additional tax imposed at the "C" corporation level for the personal holding company tax and accumulated earnings tax.
5. To reduce payroll taxes by increasing distributions and reducing salaries - although this has been challenged by the Internal Revenue Service in recent years.
6. To create a way to sell the assets of a corporation and obtain capital gain treatment taxed once at the shareholder level

Originally, the qualifications for electing "S" corporate status were very narrow. As an example, the corporation, in order to qualify, could have only a limited number of shareholders and the class of shareholders was limited. Over the years, the number of eligible shareholders gradually increased. Today, a corporation can qualify as "S" status as long as it doesn't have more than 100 shareholders and there's basically no limit on the gross revenue of "S" corporations. Very large closely held corporations having billions of dollars in gross revenue can now be taxed as an "S" (flow through) corporation.

This relaxing of "S" corporation eligibility is now being reassessed by Congress as it redefines what constitutes a "small business" and looks for ways to address the large budget crisis. In addressing the budget crisis, Congress is trying to stay away from the appearance of raising taxes, so it's looking for ways to close what some taxpayers would call "tax loopholes"; and redefining what is considered as "small business" is one of the ways it may raise revenue without actually raising tax rates.

If Congress does in fact change the way the "small businesses" are taxed, unless there's an exception for how asset sales are handled, many owners will be hit with a large tax bill when the time comes to sell their business.

Based on this **Bloomberg report**, this proposal is still very tentative and in the discussion stage; and is only one of many proposals being considered by Congress. Also, in this Bloomberg report is a very detailed 42 page report on the subject submitted by the "**Office of Tax Analysis Department of the Treasury Technical Paper 4**" issued in August 2011.

We advise all owners of "S" corporations (and LLC's) to stay close to their tax advisors in keeping current with developments on this very important subject.

Robert H. Perry & Associates, Incorporated was established in 1977, and has represented over 150 security guard company sellers located in the United States, Canada, Western Europe, South America, the Caribbean, and the Middle East.

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