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# Tax basis: The key to reducing gain on sale or deducting asset purchases

This article discusses key ideas used in reducing or eliminating gain subject to tax when you sell an interest in your business or when your business sells part or all its assets. These ideas can also possibly help those who buy or inherit a business obtain better tax write-offs.

Suppose you buy stock for \$10 and sell it for \$50. The sale generates a \$40 gain, the excess of the \$50 sale price over your \$10 purchase price. Your \$10 purchase price is referred to as your tax “basis.” However, if you die holding this stock, its basis will increase to the \$50 date-of-death value. This increase and other basis increases are referred to as “basis step-up.”

Suppose you pay \$25,000 for a piece of equipment. You might be able to write off part to all of the purchase price in the first year. The equipment’s tax basis starts at \$25,000, but then is zero when it’s fully written off. Whatever you write off reduces the equipment’s basis, eventually to zero. The reduced basis is referred to as “adjusted basis,” as contrasted with the purchase price, which is the property’s “original basis.” Generally, I will be referring to adjusted basis when I refer to basis.

Suppose you form a corporation. You invest \$100,000 in equipment, which is then written off, so that the equipment’s basis is now zero. Your basis in your stock in the corporation is referred to as your “outside basis,” and the corporation’s basis in its equipment is referred to as its “inside basis.” When you sell the stock for \$150,000, the buyer’s stock will have a \$150,000 basis, but the equipment’s basis will remain zero. Thus, outside basis will be \$150,000, and inside basis will be zero.

The buyer would prefer to have a higher basis as the result of the purchase, so that the buyer can write off the equipment. In other words, the buyer wants an inside basis step-up. For this reason and for nontax reasons, a buyer may prefer to buy assets instead of stock. However, a special election may be available to treat the stock sale as an asset sale, followed by the shareholders disposing of the stock in a liquidation. This treatment is available only if at least 80% of the stock is sold.

On the other hand, the transfer of an entity taxed as a partnership, such as a limited liability company or a limited partnership, could generate an inside basis step-up without a deemed sale of the entity’s assets. This election applies without regard to the size of the interest transferred and is available not only when an interest is sold but also when it passes by reason of death. Thus, a partnership could offer more chances for an inside basis step-up than a corporation. Although many people like to view partnerships and S corporations (corporations in which the shareholders elect to be taxed on the corporations’ income) as similar, inside basis step-up opportunities differ.

My technical materials discuss opportunities to increase outside basis, inside basis, or both. Some of my future blog articles will, in a nontechnical manner, describe outside and inside basis step-up opportunities at death or when part or all of the ownership of the business is sold.

This article is not intended to provide legal or tax advice. Please consult an appropriate professional to advise you whether these ideas might help your particular situation.

*Steve Gorin is a practitioner in the areas of estate planning and the structuring of privately held businesses. CPAs, lawyers, trust officers, family office professionals, and financial advisors are encouraged to sign up for Steve’s popular quarterly newsletter, [“Gorin’s Business Succession Solutions.”](#)*



authorsTest

steve

Steve B. Gorin