

Selling your business: Tax planning strategies to consider well before you pull the trigger

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It's time to sell your successful business — whether for a new venture or retirement. The earlier you start, the better. Early planning allows you to assemble a team of advisors (financial advisor, CPA, business attorney, estate attorney, etc.) and create a financial strategy aligned with your goals, considering taxes, income sources, expenses, risk tolerance, family needs and philanthropy. Exit planning is one of an entrepreneur's most critical decisions, with timing significantly impacting financial outcomes. Research shows that businesses planning their exit 3-5 years in advance achieve 20-40% higher valuations than those with shorter timelines.^{1,2,3}

One of the first questions advisors are often asked, "How can I reduce the tax impact from the sale of my business?" This is a great question. But make sure you aren't asking that question too late in the process. While your focus may be on closing the deal (potential buyers, deal terms, asset vs. stock sale, valuations, business assets, real estate, etc.) remember your net proceeds are also directly impacted by the capital gains tax. If minimizing taxes and maximizing net proceeds is important to you, then effective tax planning strategies should be considered well before a sale. Generally, we recommend at least two years in advance (preferably more) to ensure compliance with federal and state income tax laws in addition to estate and gift tax considerations.

What strategies may be right for you?

Qualified Small Business Stock (QSBS) — Investors and business owners receive favorable tax treatment for capital gains provided the company meets specific requirements. A qualified small business must be an active domestic C-corp with no more than \$50 million in assets on and immediately after the issuance of stock. If the stock is held for at least five years, investors can potentially exclude up to 100% of the gains from federal taxes. Under Section 1202 of the Internal Revenue Code, there are several eligibility requirements that must be met in order to qualify.

1031 Exchanges — Also known as a "like-kind exchange," Section 1031 of the Internal Revenue Code allows investors and business owners the ability to defer capital gains tax when the proceeds of a business property sale are reinvested in a similar asset or business, typically real estate.

Qualified Opportunity Zone (QOZ) — You can defer and potentially reduce your tax liability by reinvesting the gains from the sale of business property into economically distressed communities or QOZs. The timeline for QOZ deferrals ends by 12.31.2026 or earlier, if there is an inclusion event. The longer you hold the QOZ investment, the greater the tax benefits which can include a step-up in basis.

After 10 years, you may elect to increase the basis to the full fair market value on the date of the sale thus permanently excluding the growth in your investment from capital gains tax.

Employee Stock Ownership Plan (ESOP) — Selling to your employees through an ESOP may allow you to defer or avoid capital gains tax while you transition out of ownership but maintain the continuity of the business itself.

Charitable Remainder Trust (CRT) — A CRT is a tax-exempt trust that allows donors the ability to make a tax-deductible gift of appreciated assets (including closely held business assets) into the irrevocable trust, sell them, and reduce or defer the capital gains taxes. The donor receives an annuity (income for a set number of years or for life) and once the term ends, the remainder goes to charity.

Installment Sale — Structured installment sales allow business owners the ability to spread out the receipt of the proceeds over a one, two, or several years to spread out the income received and the potential tax liability over time.

When planned well in advance of a sale, there are many strategies (including those referenced above) that can help business owners protect the value of their assets and create legacies for future generations. These complex strategies require a thoughtful approach and may or may not be the best approach for you and your business.

You've built something valuable — let us help you navigate a successful exit. As you explore tax mitigation, rollover, exclusion strategies and estate transfer techniques, consult your Mesirow Wealth Advisor to determine the best approach for your unique situation.

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1. <https://exitwise.com/blog/exit-planning> | 2. <https://pentawealthmanagement.com/maximizing-exit-value/> | 3. <https://www.thealternativeboard.com/blog/exit-planning-needs-to-begin-way-before-you-plan-to-exit>

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