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Lowering Business Taxes with New Ownership Structure

By Austin Kilham

The client was in his mid-40s and the head of his family-owned business. He was worried about rising taxes on the income he and his other family members earned from that business.

Recent changes to federal tax laws and new taxes related to the Affordable Care Act had the family on track to pay 43% tax rate on its business income in 2013--an 8% increase over previous years.

"It motivated them to proactively search for creative tax techniques," says Jeff Camarda, founder and chairman of Camarda Wealth Advisory Group in Fleming Island, Fla., which manages $200 million for 500 clients.

Mr. Camarda and the client discussed strategies to reduce the family's tax burden, including different options to increase retirement-account contributions. But those moves would only delay taxes, he says. Instead, the adviser suggested a strategy that would solve the tax problem this year, and in the years to come: Changing the company's ownership structure.

The company was an S-Corporation, which generates incomes for its owners that are subject to income taxes. However, income from partnerships is subject to the lower capital-gains tax. With the 24% capital-gains tax rate, changing the business structure to a partnership would cut the family's business taxes in half.

Mr. Camarda and his client looked at partnership options. Limited Partnerships offered tax benefits but didn't protect the partners from liability for the company's debts and obligations, which was important to the family. Instead, they settled on a limited liability limited partnership, which affords the capital-gains tax benefits of partnerships while also limiting liability for partners. Although LLLP's are relatively new and aren't widely used, they are available in 22 states, including Florida.

To make the change, Mr. Camarda transferred all the assets in the S-Corporation to the LLLP and established partners from among the current ownership. All business income was then earned by the partnership, which the family could divide among themselves. That structure allowed 100% of the family's taxable income from the business to be taxed at the capital-gains rate.

Although it cost nearly $35,000 to establish the new LLLP, Mr. Camarda says, the tax savings will vastly outweigh the cost. Based on the company's projected income for 2013, the family would likely owe nearly $1.3 million in income taxes had they not restructured the company, he says. But under the new ownership structure, the family will likely owe $714,000 at the capital-gains tax rate of 24%--a savings of $606,000.


Jeff Camarda

Despite being initially concerned about the complexity of the process, the client and his family were happy they made the change, rather than sticking with the status quo.

Mr. Camarda says that it's a good reminder to consider long-term solutions to a recurring problem, rather than relying on small tweaks to solve problems year after year. "A lot of people will overpay in taxes because they are conservative and like to stay in tight parameters," he says.