TAXES

So You're Thinking of Selling?

The results are in, and according to the 2007 NACS *State of the Industry* report, convenience store sales rose to a record-high $569 billion last year, but profits plummeted by a record $4.8 billion. The staggering drop in profitability has hit multi-store owners the hardest, with many of them considering selling their stores. But thanks to a tax law provision known as the 1031 Exchange, costly tax consequences resulting from the sale of those stores can be avoided.

Terry Monroe, president of American Business Brokers, agrees that multi-store owners are seeking to sell now more than ever before, thanks to reduced profits resulting from rising prices at the pump and high credit card fees. The result has been an industry-wide drop in profits of nearly 24 percent. With the number of single-store owners continuing to increase (62 percent in 2006 according to the NACS/TDLinx Official Industry Store Count), more multi-store owners are recognizing that selling their struggling stores to the ever present throng of potential single-store buyers is an attractive option.

Traditionally, once multi-store operators have identified that option, Monroe acknowledges that potential tax implications are usually a deterrent to sales: Paying capital gains taxes of 15 percent can make sellers change their minds. "Interestingly enough, a common IRS program like 1031 is not something everyone is aware of, and it could potentially save hundreds of thousands of dollars for the seller."

The 1031 Exchange, also known as the "Like Kind Exchange," is an IRS section that allows a seller to legally defer the profit or gain of a sale to a future date. The prevailing idea behind the 1031 Exchange is that since the taxpayer is merely exchanging one property for another property of like kind there is nothing received by the taxpayer that can be used to pay taxes. (What qualifies as like kind can include other retail locations, rental properties, etc. The term encompasses a broad spectrum of property.) In addition, the taxpayer has a continuity of investment by replacing the old property. All gain is still locked up in the exchanged property and so no gain or loss is "recognized" or claimed for income tax purposes.

"If a seller closes a deal without a 1031, he could potentially lose 21 to 37 percent of his sale in taxes, depending on whether he pays capital gains or federal taxes," says Monroe. "With a 1031 Exchange, the seller rolls his profit into the purchase of a new property, thereby deferring the tax."

"A 1031 works for an owner who has a store that he bought for $200,000 ten years ago, and is ready to sell for $1 million today," says Monroe. "In order to avoid paying a capital gains tax on the $800,000 profit, the seller can identify a like-kind property prior to the sale that he can purchase, thereby rolling his profit into the purchase and deferring the tax." Keep in mind, however, that the like-kind exchange under Section 1031 is tax deferred, not tax free. When the replacement property is ultimately sold (not as part of another exchange), the original deferred gain, plus any additional gain realized since the purchase of the replacement property, is subject to tax.

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The 1031 Exchange also lays down some guidelines for the proceeds of the sale. First, the exchange must be facilitated by a qualified intermediary or accommodator — not through your hands or the hands of one of your agents — who can structure the deal according to IRS regulations. Also, the replacement property must be subject to an equal or greater level of debt than the property sold or the buyer will be forced to pay the tax on the amount of decrease.

Overall, the tax dollars saved through the 1031 Exchange may be maximized to increase cash flow and overall net worth.

Information for this article was provided by American Business Brokers, which offers consulting and broker services to clients in the convenience store industry. For more information, visit www.americanbusinessbrokers.com