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Sale of Stock in a C Corporation

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Typically, you will transfer your interest in the business to others or to your corporation in return for cash or property. This will generally result in capital gain (or loss) (or in some cases, dividends) or ordinary gain (or loss).

Caution: *When considering any sale of an interest in a business, be sure to examine all relevant documents or laws for restrictions or conditions placed on the sale of your interest in the business. These might include the document creating the business, a stock certificate, a buy-sell agreement, a loan agreement, or state or federal laws. Restrictions or conditions might be placed on (1) who you can sell your interest to; (2) whether, when, or under what conditions you can sell your interest; or (3) the price that you can sell your interest for.*

How is the sale of stock in a C corporation taxed?

Generally, the sale of your stock in a corporation results in a capital gain or loss. Thus, a sale to another person or an entity other than the corporation typically results in a capital gain or loss. However, a redemption of your stock by the corporation may be treated as a sale or exchange of the stock or as a dividend.

How is a redemption of stock in a C corporation taxed?

A redemption of your stock by the corporation can be treated as a sale or exchange resulting in capital gain or loss under certain circumstances. In general, a redemption of stock is treated as an exchange if the redemption is not essentially equivalent to a dividend, the redemption is substantially disproportionate and meets certain requirements, or the redemption terminates your interest in the corporation (attribution rules may apply).

A distribution with regard to a redemption that is not treated as an exchange of your stock is taxed first as a dividend to the extent of earnings and profits, then received tax free to the extent of your basis in the stock, and the balance is treated as capital gain.

Note: *Long-term capital gains and qualified dividends are generally taxed at 0%, 15%, or 20%, depending on the amount of the taxpayer's taxable income. An additional 3.8% Medicare tax applies to some or all of the investment income for married filers whose modified adjusted gross income exceeds $250,000 and single filers whose modified adjusted gross income is above $200,000.*

Tip: *With regard to a redemption, even if dividends are taxed at the same preferential rates as are capital gains, capital gain treatment is generally preferable to dividend treatment. Dividend treatment causes the distribution to first be taxed as a dividend, while exchange treatment allows you to recover your basis first.*

Example(s): *Assume you have a basis of $100,000 in your stock, you receive $150,000 for your stock in a redemption, and there are earnings and profits of $70,000. If the $150,000 distribution receives dividend treatment, you would have a taxable dividend of $70,000, $80,000 would be recovered tax free as basis, and $0 would be taxable as capital gain. If treated as an exchange, you would recover $100,000 tax free as basis, and the remaining $50,000 would be taxable as capital gain. With dividend treatment, $70,000 is taxable; with exchange treatment, only $50,000 is taxable.*

Section 306 stock

Sales of Section 306 stock may also be taxed first as a dividend to the extent of earnings and profits, then received tax free to the extent of your basis in the stock, and the balance is treated as capital gain. Section 306 stock is usually preferred stock received as a nontaxable dividend or in a transaction in which no gain or loss is recognized.

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