Long-term Capital Gains Tax Rates May Be Increasing. Business Owners Should Consider the Potential Impact.

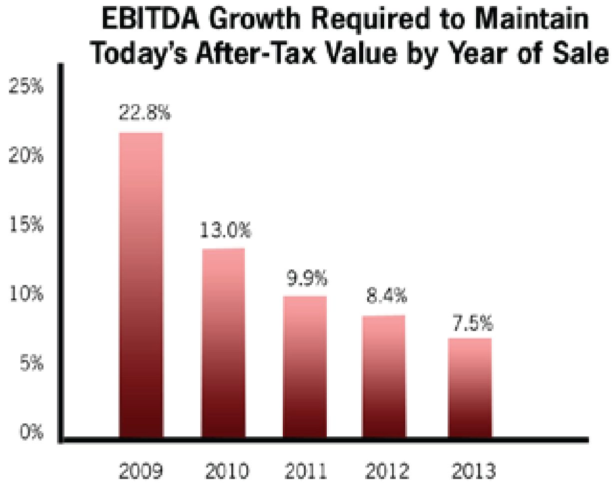
According to Fortune Magazine[1], Democratic presidential candidate Barack Obama "would increase the 15 percent capital gains tax rate – probably to 25 percent, according to advisors." Others suggest Obama may raise the federal long-term capital gains rate to as high as 28 percent and that this change could be retroactive to January 1, 2009.

How would this increase in capital gains rates impact a company's after-tax value?

Consider the following scenario: Let's assume a company generates $5 million of annual EBITDA[2] and is valued at $25 million. As summarized below, if this company were sold for $25 million before December 31, 2008, the after tax-value to the company's owners would total $21.25 million[3]. However, if the same company were sold for $25 million after December 31, 2008, then the after-tax value to the company's owners would total $18 million, resulting in $3.25 million in lost value[4].

How would a company have to grow in order to maintain its current after-tax value?

The graphic below summarizes the EBITDA growth rate required over time to maintain – not grow – a company's after-tax value today. That is, a company would have to grow its EBITDA by 22.8 percent in 2009 just to maintain its current after-tax value[5]. Looking five years out, a company would have to grow its EBITDA by 7.5 percent every year for five years just to maintain its current after-tax value[5].



To Learn More

If you are interested in learning more about how an increase in the federal capital gains tax rate may affect the after-tax value of your company, please contact:

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DW Healthcare Partners (DWHP) is a healthcare-focused private equity firm that invests in high-growth companies. DWHP provides both capital and strategic resources to accelerate growth and increase shareholder value.

Footnotes:

1. Fortune Magazine. "What Obama Means for Business." July 7, 2008.
2. EBITDA is defined as Earnings Before Interest, Taxes, Depreciation and Amortization.
3. Assuming the current 15 percent federal long-term capital gains rate. Analysis of long-term capital gains rates by state is excluded.
4. Assuming a 28 percent federal long-term capital gains rate made retroactive to January 1, 2009. Analysis of long-term capital gains rates by state is excluded.
5. Assuming a constant valuation approach and a 4 percent annual discount rate.

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