A Resurgence of the Capital Gain Exclusion Under Section 1202 (Qualified Small Business Stock)

UTCLE LLCs, LPs and Partnerships
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Agenda

I. Overview of Section 1202

II. Considerations for Business Owners and Investors

III. Use of Pass-Through Entities

IV. Q&A and Discussion

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Overview of Section 1202

Section 1202 Gain Exclusion

- Non-corporate taxpayers can exclude 100% of the gain from the sale or exchange of qualified small business stock (“QSBS”) if (1) acquired after September 27, 2010 and (2) held for more than 5 years

- Gain exclusion (on a per-issuer, per-taxpayer basis) is the greater of:
  - $10 million lifetime exclusion ($5 million each for married people) OR
  - 10x aggregate adjusted basis of stock sold during the tax year

QSBS Requirements at Issuance

- Corporation must be a "Qualified Small Business" ("QSB")
  - Domestic C corporation
  - Aggregate gross assets of $50m or less at all times before and immediately after issuance
  - Active business requirement (certain types of businesses)

- Calculation of aggregate gross assets
  - Gross assets = cash and adjusted basis of other property
  - For contributed assets, adjusted basis = fmv at contribution
  - More than 50%-owned subsidiaries treated as part of parent corp.

- Stock must have been acquired in an original issuance
  - Directly from corporation (i.e., cannot purchase from existing stockholder)
  - In exchange for money, other property (excluding other stock), or services

Active Business Requirements

- At least 80% of assets (by value) are used in the active conduct of a qualified trade or business
  - Not "qualified": most professional services, banking/investing, farming, hospitality, and oil and gas activites
  - Subsidiary's assets and activities are ratably attributed to Parent
  - Special rules for working capital and real estate investments
  - Includes start-up and R&D activities

- Must be an "eligible" corporation
  - Excludes DISCs, RICs, REITs, REMICs, and cooperatives

- Both must be met during "substantially all" of taxpayer's holding period