

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

UTCLE LLCs, LPs and Partnerships

Thursday, July 13, 2023

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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

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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

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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 activities
 - 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

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First appeared as part of the conference materials for the
32nd Annual LLCs, LPs and Partnerships session

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