

Client Alert.

December 17, 2010

Temporary 100% Exclusion for Gain From Certain Small Business Stock Extended

By Stephen L. Feldman and Arthur Man

INTRODUCTION

Late last evening, the House of Representatives passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (H.R. 4853, the “Act”) one day after the Senate passed it. President Obama is expected to sign the Act into law soon. The Act has extended the 100% income exclusion available to non-corporate taxpayers for gain from sale of “qualified small business stock” (“QSBS”).

SUMMARY

As we highlighted in an earlier client alert,¹ the Small Business Jobs Act of 2010 (“SBJA”) increased the exclusion from taxable income for gain from sale of QSBS to 100%² for QSBS held for at least five years. In addition, the SBJA provided that none of such gain is subject to the alternative minimum tax (“AMT”) which previously had been a significant impediment to the QSBS incentive. As we pointed out, under the SBJA, both of these changes applied only to QSBS acquired after the date of enactment of the SBJA (September 27, 2010) and before the end of 2010.

As mentioned in our prior alert, the very limited window for application of the 100% exclusion would likely limit its value as a meaningful incentive. Fortunately, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extends the 100% exclusion (for both regular tax and AMT purposes) to QSBS acquired after September 27, 2010 and before January 1, 2012. The five year holding period requirement continues to apply. Accordingly, taxpayers have one additional year to acquire QSBS the sale of which could qualify for the 100% exclusion.

EXPLANATION

Stock is QSBS only if all of the following requirements are met: (i) the taxpayer acquired the stock at original issue in exchange for money or property other than stock, (ii) the stock was issued after August 10, 1993, (iii) the issuer of the stock was a “qualified small business” when the stock was issued, (iv) the corporation meets an active business requirement “during substantially all of the taxpayer’s holding period” for the stock, and (v) the corporation is a C corporation when the stock is sold and during substantially all of the taxpayer’s holding period for the stock. A “qualified small business” is a domestic C corporation that has not more than \$50 million in assets. A corporation will meet the active business requirement if at least 80% of its assets, by value, are used in the active conduct of one or more “qualified” trades or businesses and the corporation is an “eligible corporation.” The term “qualified trade or business” includes all trades or businesses other than the following categories of disqualified activities such as various professional and business services; banking, insurance, financing, leasing, investing, and similar businesses, and “the ownership of, dealing in, or renting of real property.”

¹ See Morrison & Foerster LLP Legal Update, “Small Business Jobs Act of 2010 – Key Tax Incentive Provisions” available at: <http://www.mofo.com/files/Uploads/Images/100928-Jobs-Act.pdf>.

² Prior to 2009, the percentage exclusion had been 50% but was increased to 75% for QSBS acquired after February 17, 2009 and before January 1, 2011.

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For more details about the changes to the QSBS rules made by the Small Business Jobs Act of 2010, please see our [client alert dated September 28, 2010](#).³

For questions or comments, you may contact our Federal Tax Department.

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Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

³ See footnote 1.