January 10, 2011 | Posted By

Extension of 100% Gain Exclusion for Qualified Small Business Stock

Included in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 signed into law on December 17, 2010, a tax incentive relating to qualified small business stock ("QSBS") was extended for another twelve months. Pursuant to this extension, noncorporate taxpayers are allowed to exclude all (100%) of their gain from the sale or exchange of QSBS (subject to a variety of special rules), provided that the stock is acquired after September 27, 2010 and before January 1, 2012. The gain exclusion provision only applies to QSBS held for more than five years. The amount of gain from the sale of QSBS that can be excluded by a taxpayer is generally limited to the greater of $10,000,000 (in the aggregate) or 10 times the tax basis of the QSBS sold. Generally speaking, and with a few exceptions, QSBS must be acquired when it is issued in exchange for money, property (other than stock) or services.

Also, to qualify as QSBS the stock must be stock in a corporation that:

1. for substantially all the time that the stock is held is not a mutual fund or other special type of corporation;
2. at the time the stock is issued and for substantially all the time that the stock is held, is a U.S. corporation and is *not* an S corporation;
3. at all times after Aug. 10, 1993, and before the issuance of the stock, has gross assets that don't exceed $50,000,000 (taking into account predecessor and affiliated corporations);
4. immediately after the stock is issued, has gross assets that don't exceed $50,000,000 (taking into account affiliated corporations);
5. for substantially all the time that the stock is held, uses—taking into account subsidiary corporations—more than 80% of its assets in the active conduct of a trade or business. Some types of businesses (like farming), even if actively conducted, don't count toward satisfaction of this 80% “active business” test, and some investments in real estate, stocks or securities can cause an otherwise qualifying corporation to fail the 80% test.

There are special rules relating to the calculation of the gain that can be excluded. For example, if appreciated property is contributed in exchange for QSBS, the "built-in gain" that existed in such property at the time of the contribution may not be excluded from income (and therefore would be subject to tax at normal tax rates) when the QSBS is ultimately sold.

Importantly, this special rule also applies for alternative minimum tax (AMT) purposes.

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