SCHELL BRAY PLLC
Attorneys and Counselors at Law

Income Exclusion for Qualified Small Business

BY KRISTIN KING

Exclusion of Gain on Qualified Small Business Stock

A noncorporate taxpayer can exclude at least some portion of gain from the sale of ***qualified small business stock*** held for more than five years. The portion of the gain that is excluded is determined by the date on which the stock was acquired and there is a cap on the overall amount of gain that can be excluded. In addition to exclusion for regular income tax, all or a portion of the gain is excluded from the alternative minimum tax as well.

General Requirements

1. **C Corporation**. The stock must be stock of a domestic C corporation (*i.e.*, S corporation stock not eligible).

2. **Original Issuance**. The taxpayer must have acquired the stock at original issue from the corporation after August 10, 1993. (Certain stock acquired from persons who met this test or in certain exchanges may qualify.)

3. **Five-year Holding Period**. The taxpayer must have held the stock for more than five years.

4. **$50 Million Gross Asset Test**. At all times before the stock was issued and immediately thereafter, the total gross assets of the issuing corporation (and certain related entities) cannot have exceeded $50 million.

5. **Active Qualified Business Test**. During substantially all of the taxpayer's holding period of the stock, at least 80% of the corporation's assets are used by the corporation in the active conduct of one or more qualified trades or businesses. A qualified trade or business means any trade or business *other than* the following:

    a. Performance of services in a trade or business where the principal asset is the reputation and/or skill of one or more of its employees, including, *e.g.*, health, law, engineering, architecture, financial services and consulting;
    b. Banking, insurance, financing, leasing, investing or similar business;
    c. Farming;
    d. Production or extraction of oil and gas, minerals, or other items subject to special depletion deductions; or
    e. Operation of a hotel, motel, restaurant or similar business.

    For purposes of meeting the active qualified business test, assets used for start-up activities, research and experimentation may qualify, and look-through rules apply for certain subsidiaries.

Certain categories of corporations can never satisfy the test, *e.g.*, DISCs, RICs, REITs and REMICs. In addition, securities and real estate investment holdings in excess of 10% may cause a corporation to fail the active qualified business test.

6. **No Prohibited Redemptions**. Certain corporate redemptions from the taxpayer or a related person may cause later acquired stock to be disqualified for gain exclusion. Also, significant redemptions of stock during specified periods before or after the date of issuance may disqualify the issued stock from the exclusion.

Excluded Gain

The portion of the gain on qualified small business stock that can be excluded from income is determined by reference to the date on which the stock was acquired as follows:

Acquisition Period	Exclusion Percentage
Before February 18, 2009	50% (60% on certain empowerment zone business stock)
February 18, 2009 – September 27, 2010	75%
September 28, 2010 and after	100%

Overall Limitation

A taxpayer's total amount of gain eligible for exclusion from income is subject to a *per-issuer* limitation equal to the *greater of* (i) $10,000,000 and (ii) 10 times the taxpayer's adjusted basis in the stock.

Qualified Small Business Stock Held by Pass-Through Entities

If a taxpayer holds an interest in a pass-through entity (*e.g*., partnership or S corporation) that sold qualified small business stock, the taxpayer will qualify for the exclusion if he held the interest on the date the entity acquired the stock and at all times thereafter until the stock was sold.

Kristin King is a member of Schell Bray's Business Practice Group and assists and advises clients on a diverse range of tax matters relating to entities, individuals and business and investment transactions.