

# small business stock

Take advantage of preferential tax treatment available for certain small business stock.



## SMALL BUSINESS STOCK TAX BENEFITS

Although usually a more speculative investment, qualified small business (“QSB”) stock can qualify for preferential tax treatment, including:

- Rollovers of gain when the proceeds are used to buy other qualified small business stock,
- Reduced tax rates, or
- Ordinary loss rather than capital loss treatment, even if you have held the property long-term.

## QSB STOCK ROLLOVER

The gain from the sale of QSB stock is eligible for a rollover which allows you to defer the tax on the gain. QSB stock is defined as stock of a domestic corporation that:

- Originally issued its shares after August 10, 1993,
- Did not have gross assets exceeding \$50 million at any time before or immediately after issuing the stock, and
- Is actively engaged in a qualifying trade or business.

**Note:** *Businesses in certain industries, such as hospitality, financing, professional services, and mining, do not qualify for this treatment. Also, the rollover provision does not apply to stock of an S corporation.*

To qualify for this rollover, you need to both own the stock for at least 6 months and reinvest the proceeds within 60 days of sale in other QSB stock. The replacement stock you buy in the rollover then qualifies for a future rollover under the same rules. The basis in the replacement stock is reduced by the deferred gain from the rollover and inherits the holding period of the stock you sold for determining long-term capital gain treatment.

**Note:** *There is no carryover of holding period for purposes of determining the “more-than-6-months” requirement.*

If the stock is held by a pass-through entity of which you are a partner or shareholder, the entity can buy replacement stock and elect a tax-free rollover of the gain. Or it can notify you of the gain and you can defer tax by buying the replacement stock directly. The 60-day rule still applies, beginning on the day the entity sells the QSB stock — not when they notify you of the sale.

## REDUCED TAX RATES

Taxpayers that hold QSB stock for more than 5 years (based on purchaser’s first date of ownership as a C corporation) may exclude the gain on the sale of the QSB stock from gross income; the amount of exclusion is staggered based on tax holding dates. The tax holding date is the date computed under section 1223 which includes your holding period prior to conversion to a C corporation.

- 100% of the gain if the stock has a tax holding date after September 27, 2010. This provision has been made permanent as a result of PATH.
- 75% of the gain if the tax holding date is after February 17, 2009 and before September 28, 2010.
- 50% of the gain if the tax holding date is before February 18, 2009.

The tax rate on the included gain is 28% meaning that the 50% exclusion gives you an effective rate of 14% compared to the capital gains tax rate of 20% now in effect.

**Note:** *Rollovers into new QSB stock are still available as long as the replacement period is observed (see above).*

**Note:** *Eligible gain from a single issuer is subject to a cumulative limit for any given year of the greater of (a) \$10 million reduced by eligible gain taken in prior years or (b) 10 times the cost of all qualified stock of the issuer disposed of during the tax year.*

## AMT ADJUSTMENTS

Although excludable for regular tax purposes, a portion of the excluded gain on the sale of QSB stock is an AMT preference item. The preference rates are also based on purchase dates:

- No preference adjustment for stocks with a tax holding date after September 27, 2010, resulting from the enactment of PATH. This provision has been made permanent.
- 7% of the excluded amount for all other dates.

The AMT preference that was originally scheduled to increase from 7% to 42% after 2012 has been permanently extended at 7% by ATRA.

**Caution:** *If you have net capital losses and take the exclusion, remember to consider that the AMT preference will cause you to utilize your AMT capital losses.*

chart

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## SECTION 1202 TAX RATE SCHEDULE SALES

Year of purchase	Regular net tax rate*	AMT effective rate	Capital gain rate	Benefit if in AMT
Pre 2001-02/17/2009	15.9%	16.88%	23.8%	6.92%
02/18/2009-09/27/2010	7.95%	9.42%	23.8%	14.38%
Post 09/28/2010	0%	0%	23.8%	23.8%

**Planning Tip:** Qualified small business stock held for 5 years can result in additional savings.

*\*Including the Medicare Contribution tax of 3.8%. Savings assumes no deductions against net investment income.*

## CLAIM ORDINARY — NOT CAPITAL — LOSSES

If you sell qualifying small business stock at a loss, you can treat up to \$100,000 (\$50,000 if married filing separately) of the loss as an ordinary loss rather than a capital loss, even if you have held the stock for more than 12 months. This loss is available toward the computation of net operating losses.

To qualify for this treatment you must have bought the stock at original issue and continuously held it until disposition. The issuing corporation must have had an initial capitalization of \$1 million or less at the time the stock was issued and derived not more than 50% of its income from investment activities (such as interest, dividends, royalties, rents, annuities, and sales or property exchanges) during the preceding 5 years.