



Exploring the Potential of Qualified Small Business Stock (QSBS)

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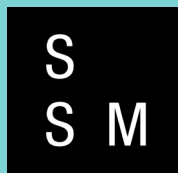
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Basic §1202 QSBS Benefits Overview



Exclude gain from taxable income for federal income tax purposes (post-2010 stock acquisitions) equal to:

Higher of:

- \$10MM per shareholder, per corporation, or 10 times the tax basis in stock sold or exchanged during year (up to \$500MM per issuer).



State income tax

Most states have similar benefits (but not: CA, NJ, PA and a few others).



Stock must be held for more than five years.



QSBS Tax Benefits

		QSBS 50% Exclusion	QSBS 75% Exclusion	QSBS 100% Exclusion		Non-QSBS
Total Sale Proceeds		\$20,000,001	\$20,000,001	\$20,000,001		\$20,000,001
Less: Purchase Price		\$1	\$1	\$1		\$1
Total Gain		\$20,000,000	\$20,000,000	\$20,000,000		\$20,000,000
Less : QSBS Exclusion		\$5,000,000	\$7,500,000	\$10,000,000		\$0
Remaining Gain		\$15,000,000	\$12,500,000	\$10,000,000		\$20,000,000
Tax rate(Federal + NIIT)		23.8%	23.8%	23.8%		23.8%
Tax savings due to QSBS		\$1,190,000	\$1,785,000	\$2,380,000		\$0

Exclusion Percentages Vary*

100% Exclusion: for stock issued after September 27, 2010

75% Exclusion: for stock issued after February 17, 2009, through September 27, 2010

50% Exclusion: for stock issued after August 10, 1993, through February 17, 2009



Qualifying For QSBS Status

Type of business is **NOT**:

- Certain regulated services businesses (law, engineering, accounting, health).
-But company product or services offered may be used in those industries, depending on the facts.
- Other services businesses whose principal asset is the skill or reputation of 1 or more employees.
- Consulting, financial services, banking, investing, insurance.
- Real estate, hotels, restaurants, farming, commodities extraction, etc.



Active Trade or Business Test



Asset Test

- At least 80% of assets (by value) used in active conduct of trade or business.
- Stock, securities, and real estate not used in business may be problematic.
- Look-through rule for corporate subsidiaries (pass-through entities?).

Exceptions

- Start-up activities; assets used to fund working capital needs or R&E expense.



SAFEs and Convertible Debt



Neither treated as stock

Five-year holding period does not begin until stock acquired

Note Recent proposed legislation would allow holding period tacking for convertible debt



Special Considerations; Loss of QSBS Status



Change in type of business

Cannot move into excluded business.



Passive assets (loss of active status)

Stock, securities, ownership of partnerships or LLC's (but WC or R&E exceptions).

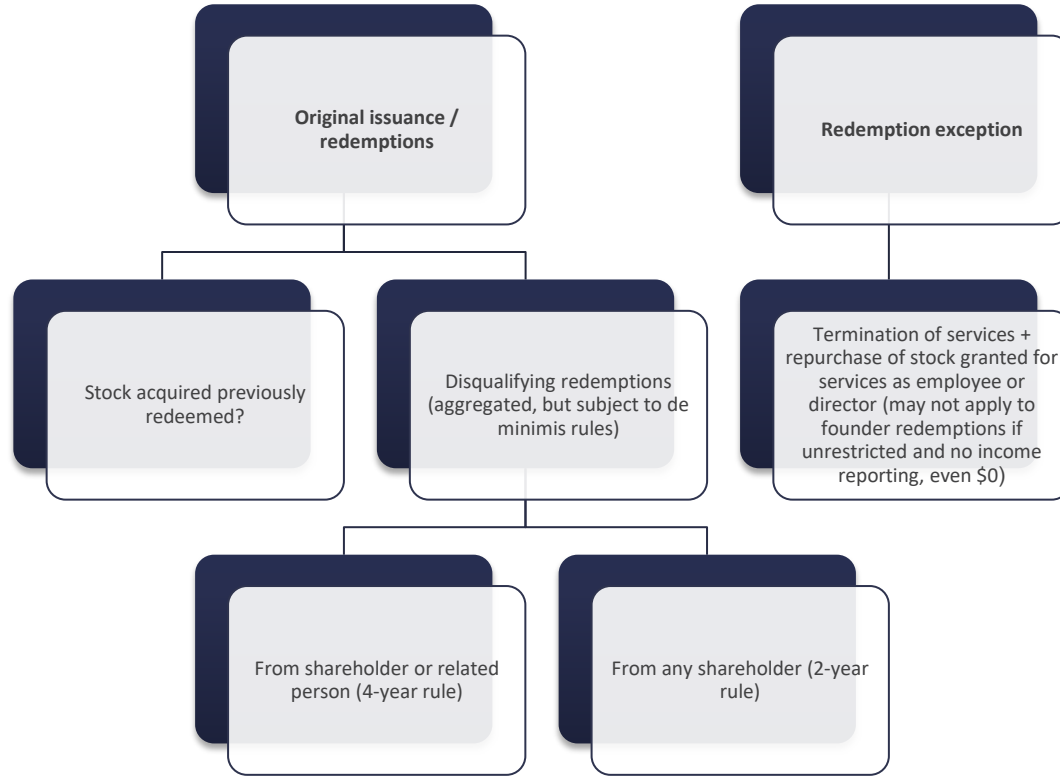
More than 10% of assets made up of stock or securities in corps, by value (pass-throughs?) .

Total asset value (denominator) is reduced by liabilities.

Real estate (more than 10% by value if not used in business).



Special Considerations; Loss of QSBS Status Cont.



Special Considerations; Loss of QSBS Status Cont.

Prior Contributions of property (especially IP)

- Tax basis = FMV.
- \$50MM gross asset test: cash + tax basis in property.
- FMV of property at time of contribution may be unknown or fact of contribution ignored .

Gross Assets at stock acquisition vs. historical

- Easy to look past historic gross asset levels (e.g., IP w/ FMV \$15.1MM initially contributed + \$35MM raised and spent, such that IP is only asset on books when stock issued).



Special Considerations; Loss of QSBS Status Cont.



Transfers of stock to legal entity

Loss of QSBS status if §1202 and §351 or §368 requirements not met (including §1202 80% control requirement with §351 contributions).



Taxable sale of stock to trust for estate planning purposes

Gift/death required for QSBS status to carry over.
No acquisition via original issuance for trust (but consider grantor trust status).



Transfer of interests in pass-through entity that holds QSBS (assuming not DRE)



Hedging Transaction; Pledging Stock



Short sales, put options, and similar transactions

- May cause deemed sale of stock.

Pledging QSBS as security for nonrecourse loan

- Open question.



Exits Before Five-Year Holding Period



Section 351 contribution or section 368 tax – free reorganization.

- Provided requirements of section 1202 are met.

Section 1045 rollovers

- Replacement QSBS within 60 days.



Partnerships and QSBS – Planning Opportunities

Maximize stock basis for QSBS exclusion

Basis is FMV at the time of conversion

Capital gain tax on built-in gain

5-year holding period starts on the date of conversion



“Stacking’ QSBS Exclusions

Powerful income and estate tax planning strategy

When structured correctly, a way to get additional exclusions

Considerations:

- Obtain formal opinion on QSBS status – can apply to investors and others at the company.
- Establish trust in a state that follows federal QSBS rules.
- Typically structured as gift, gifting at a lower valuation uses less lifetime exemption.

Requires valuation for gift taxes purposes, not 409A

Thorough modeling at various exit scenarios





We'll get you there.

CPAs | CONSULTANTS | WEALTH ADVISORS

Questions

Thank You



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