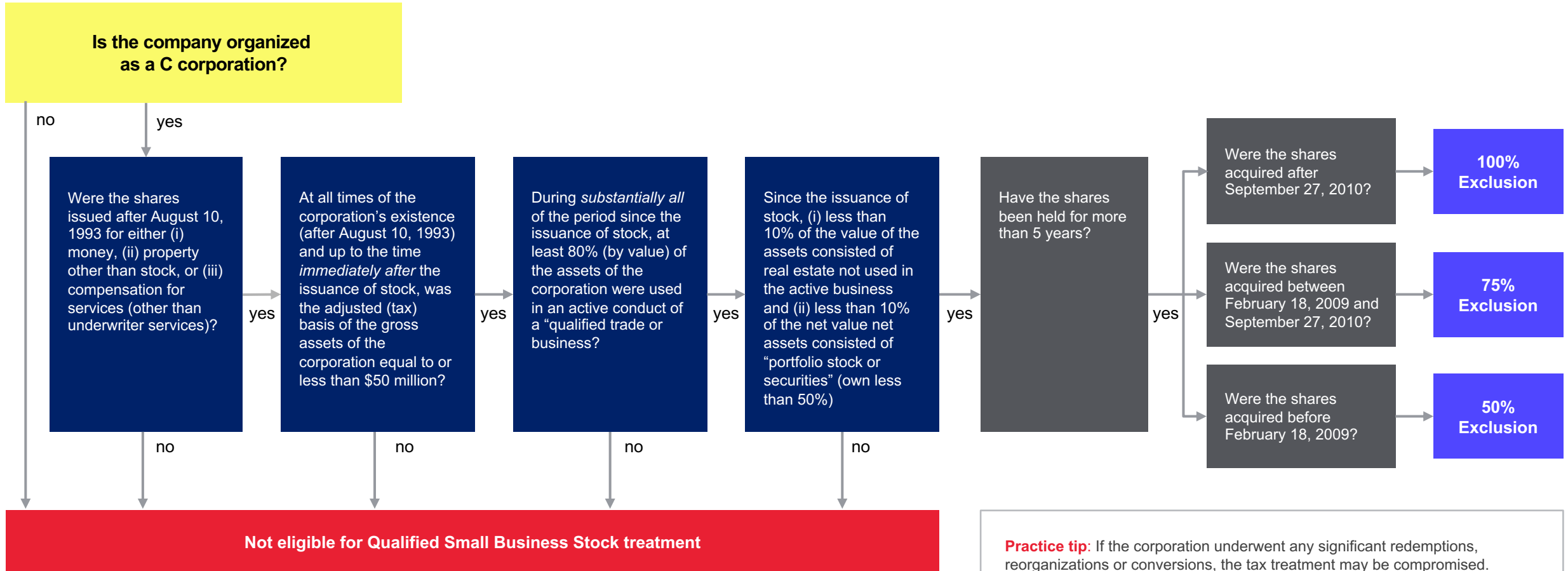


Section 1202 Qualified Small Business Stock Cheat Sheet



Practice tip: If the corporation underwent any significant redemptions, reorganizations or conversions, the tax treatment may be compromised. Please check with a member of the Tax Department.

Section 1202 Qualified Small Business Stock Cheat Sheet

- The entity must be a C corporation. 1202(c)(1). Special entities like REITs, RICs, REMICs, DISCs, cooperatives and other pass through entities (S corporations) are not eligible. 1202(e)(4).

- The corporation MUST be under the \$50 million threshold at all times after August 10, 1993 and through the time of the share issuance. 1202(d)(1)(A).
- Note that the test says immediately after the share issuance. That means that it includes the issuance (and thus counts any money or property contributed as part of the issuance) in calculating the limitation. 1202(d)(1)(B).
- The adjusted (tax) basis of the aggregate gross assets includes the fair market value of any assets contributed to the corporation (rather than the adjusted tax basis) determined as of the date the assets were contributed. 1202(d)(2)(B).

A “qualified trade or business” means a business **other** than:

- performance of services in the fields of:
 - health
 - * law
 - engineering
 - architecture
 - accounting
 - actuarial science
 - performing arts
 - consulting
 - athletics
 - financial services
 - brokerage services
 - or any trade or business where the principal asset is the reputation or the skill or one or more of its employees
- Banking, Financing, Insurance, Leasing, Investing or similar business.
- Farming, Gardening, Growing or other Agricultural Business.
- Mining, Drilling or other Extraction type Business.
- Operation of a Hotel, Motel, Restaurant or other Hospitality Services. 1202(e)(3).

- For purposes of the active business test, a parent corporation “looks through” to its subsidiaries and counts a “ratable” share of the subsidiaries’ business assets and business activities for purposes of the test. 1202(e)(5)(A).
- A parent must own more than 50% of the combined voting power of all classes of stock entitled to vote or more than 50 percent of the value of all outstanding stock. 1202(e)(5)(C). Any ownership of less than 50% constitutes a portfolio investment that is not considered active. 1202(e)(5)(B).
- A reasonable amount of working capital can be counted as part of the business assets of a corporation. 1202(e)(6)(A).
- This may include investments that are reasonably expected to be used within 2 years to fund research and experimentation expenses of a qualified business. However, a corporation in existence more than 2 years is limited to 50% of its assets under this exception. 1202(e)(6)(B).

- If stock qualifies, then some or all of the gain from the sale may be excluded by the selling shareholder based on when the shareholder acquired the shares
- Remember that the rules regarding capital gains treatment have changed – thus, calculating the exclusion under the 50% and 75% exclusions requires more complicated calculations (also AMT and the 3.8% Medicare tax need to be considered in certain instances).
- A shareholder has a limitation on the amount of stock that is excluded under Section 1202 equal to the greater of:
 - \$10 million (reduced by any amount excluded in prior years from sales of the same corporation stock); and
 - 10 times the taxpayer’s aggregate adjusted bases of qualified small business stock issued by the corporation.
 - Section 1202(b)(1).