Anchin Alert

Anchin, Block & Anchin LLP
Accountants and Advisors

December 28, 2016

Qualified Small Business Stock: A Gem for Investors and a Marketing Tool for Entrepreneurs

In this day and age, investors (Venture Capitalists, Private Equity, and Angel Investors) are concerned about maximizing their internal rate of return (IRR). Maximization of this important metric cannot be accomplished without minimizing the potential tax leakage of an investment. One feasible planning tool that can be used to achieve this goal is Internal Revenue Code (IRC) §1202.

IRC §1202 allows non-corporate taxpayers to exclude from income a certain percentage of gain derived from the sale or exchange of Qualified Small Business Stock (QSBS).

To qualify as QSBS, the entity:

- Must be a domestic C-corporation
- Gross assets must not exceed a value of $50,000,000 at any time on and before the issuance of the stock
- Stock is required to be acquired at original issue and not from the secondary market
- Uses at least 80% of its assets in the active conduct of one or more qualified trade or businesses. Generally speaking, companies operating within the Consumer Product industry are considered to be a qualified trade or business.

The taxpayer is required to hold the QSBS for at least five years to receive preferential treatment. Furthermore, the amount of the gain excluded depends on the acquisition date. See the table below for more details:

Gain Exclusions:

Acquisition Date	Percent Exclusion	Alternative Minimum Tax (AMT) Add-back
Before February 18, 2009	50%	7%
Between February 18, 2009 – September 27, 2010	75%	7%
Post September 27, 2010	100%	0%

Other Considerations:

The information disclosed above provides a simple introduction to this specific planning tool. However, you should consider the following in your calculation of QSBS:
An addback of a portion of the excluded gain for AMT purposes

- Gain exclusion is limited to the **greater of:** $10 million or 10 times the taxpayer's adjusted basis
- IRC §1202 applies to both common and preferred stock
- IRC §1202 possesses a look-through rule, where the qualified business requirement will be satisfied through a subsidiary corporation that is at least 50% owned. (C-Corp blocker structures).
- Many states conform to the federal rules, however some do not.

- IRC §1045 which provides another planning opportunity (outside the scope of this alert) can be used along with IRC§1202 to defer the recognition of gain, a similar concept to like-kind exchanges.

For more information on this planning tool and how it can be implemented in your business or particular investment, please contact your Anchin relationship partner or James Ferrara, a Partner in Anchin's Food and Beverage Industry Group, at 212.840.3456 or info@anchin.com.

ANCHIN®
Your Expert Partner
Accountants and Advisors

Anchin, Block & Anchin LLP
Accountants and Advisors
1375 Broadway, New York, NY 10018
212.840.3456 • www.anchin.com