



NORTHERN  
TRUST

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# Qualified Small Business Stock:

## *The Quest for Quantum Exclusions (Queries, Qualms, Qualifications & QOZ)*

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# Qualified Small Business Stock: Good, Bad, Ugly?

## QUINTESENTIALLY COMPELLING

- ✓ 100% Capital Gain Exclusion
- ✓ Rollover Taxable Gains
- ✓ Multiply (Stack & Pack) Exclusion

## QUASHING QUALIFICATIONS

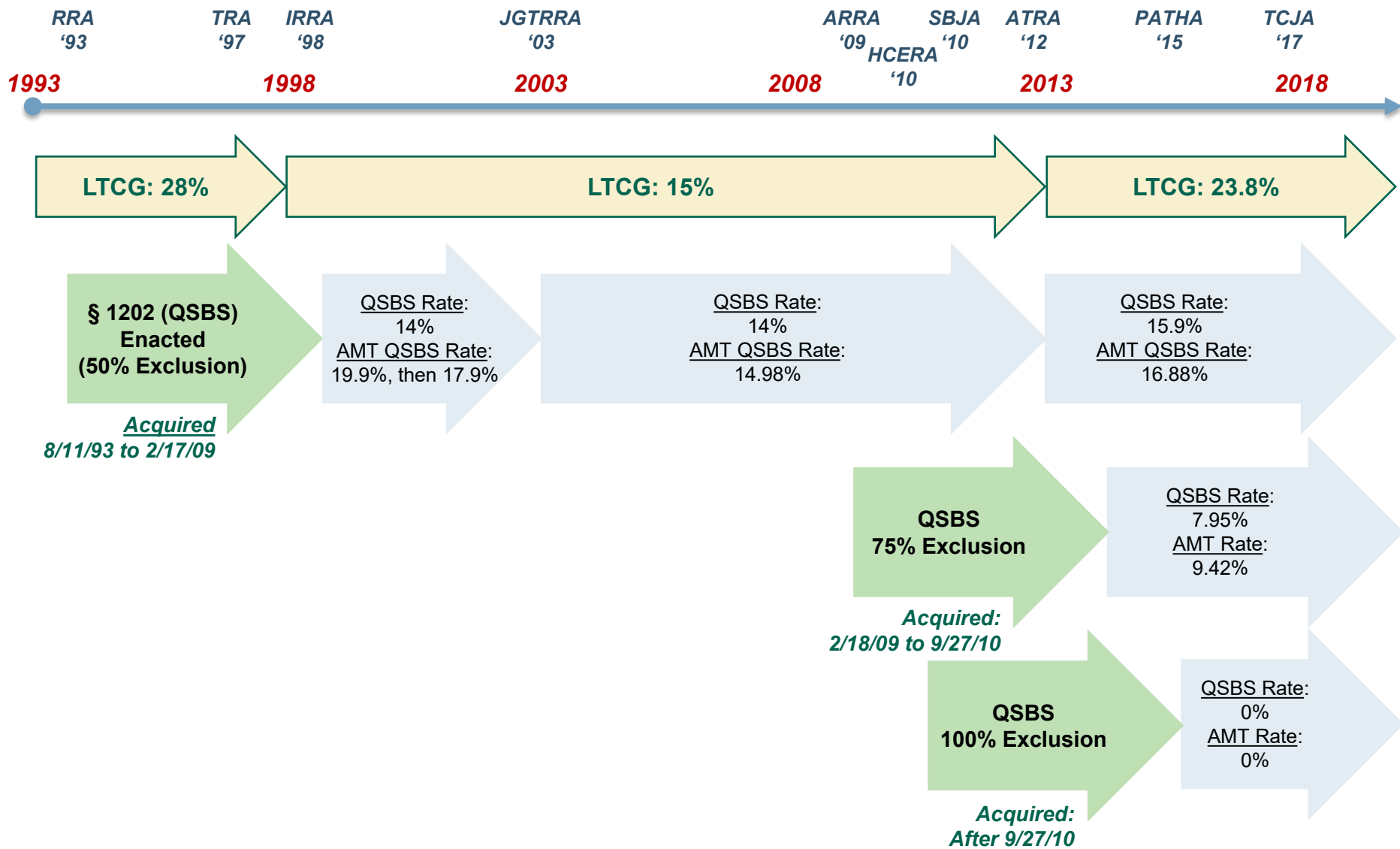
- ❖ C Corporation
- ❖ 5-Year Holding Period
- ❖ Applies to Stock Sale (Not Assets)

## QUARRELSOME QUAGMIRE

- Quixotic Definitions
- Quirky Qualifications
- Quibbling IRS Guidance

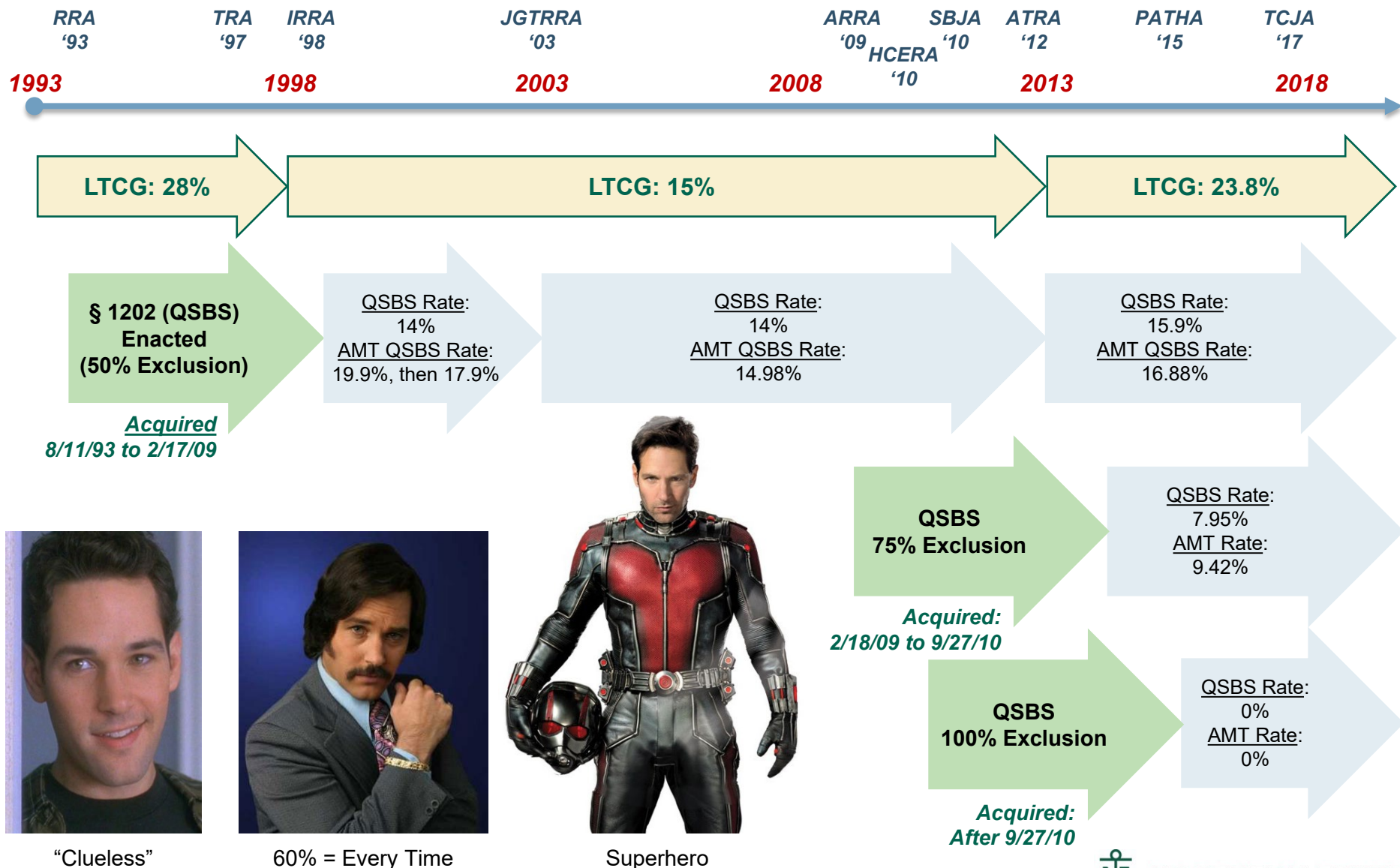


# QSBS: 25 Years to Mature



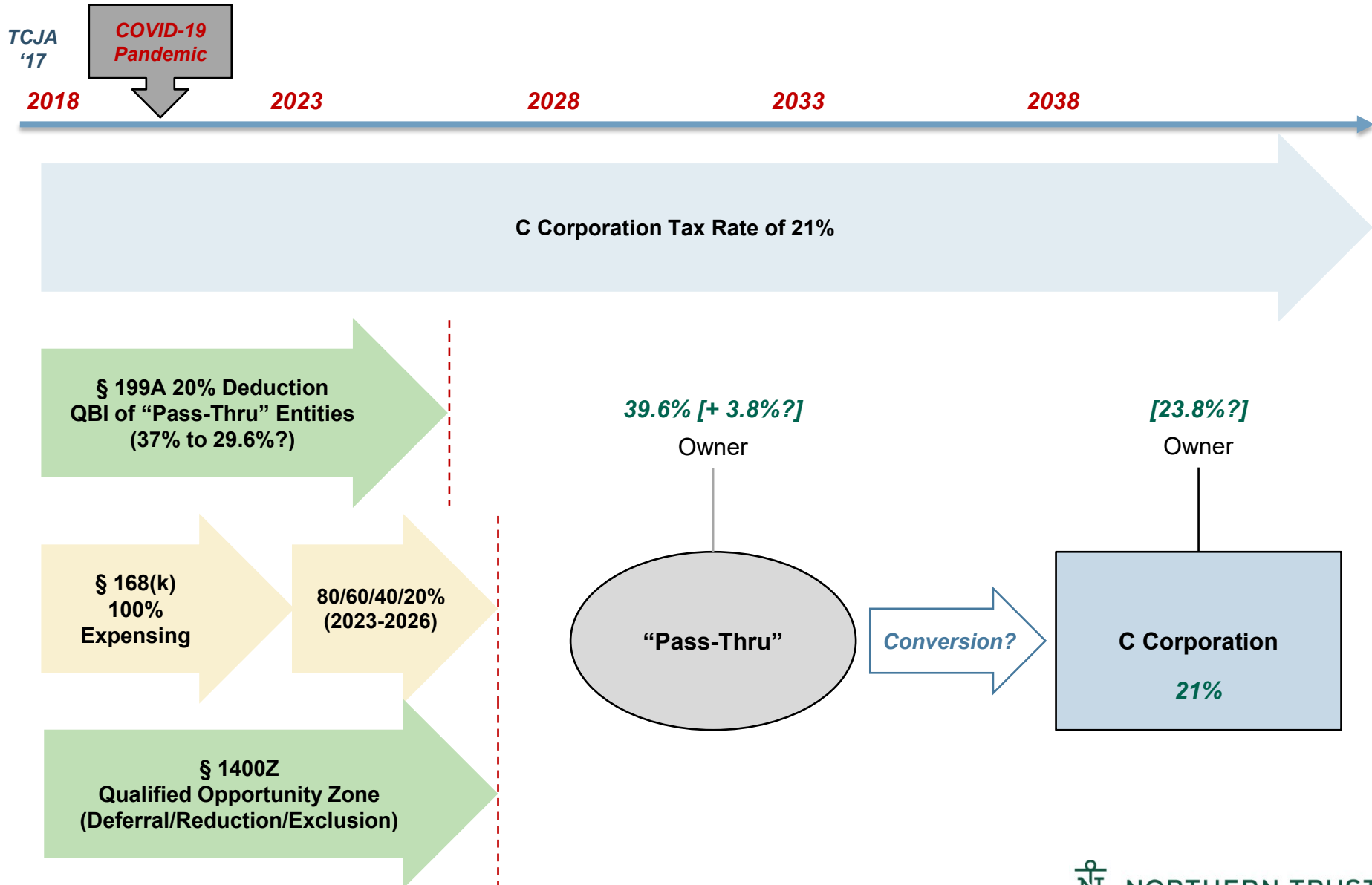


# QSBS: 25 Years to Mature



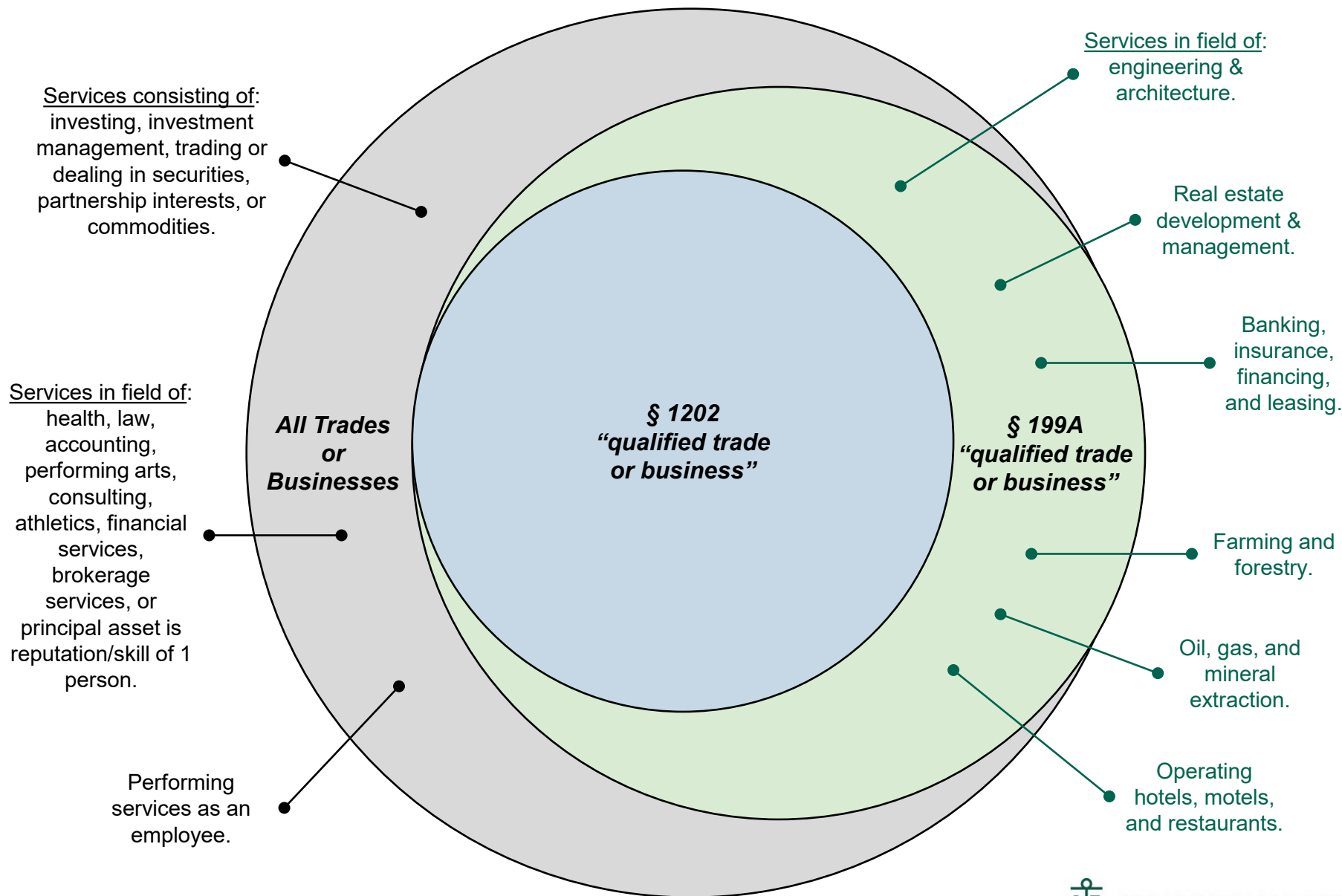


# QSBS: 25 Years to Mature (TCJA Creates Path to QSBS)



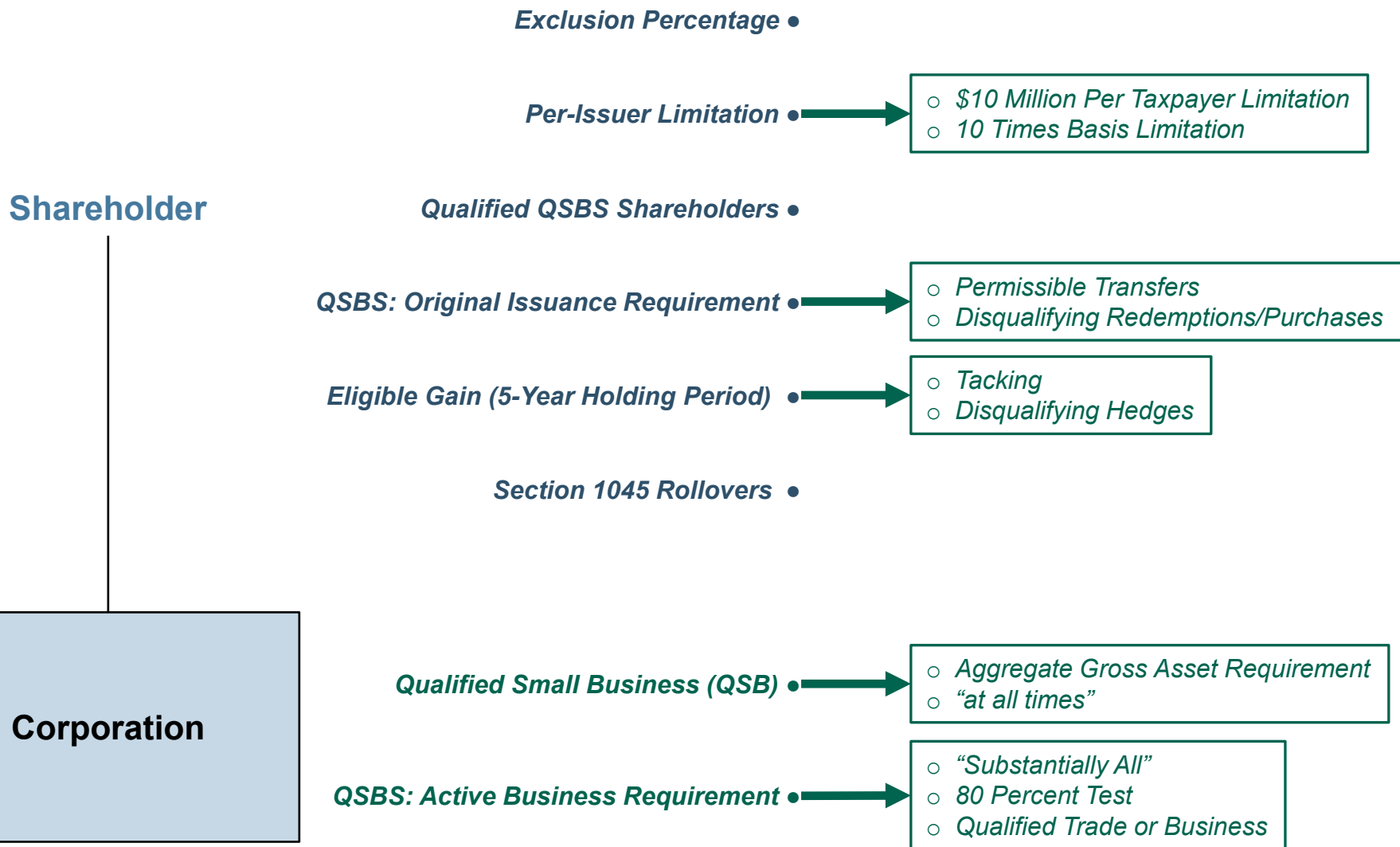


# “Qualified Trade or Business” Overlap





# QSBS & QSB: Corporate and Shareholder Qualifications





## QSBS Basic Elements: Exclusion Percentage

Acquisition Date	Exclusion Percentage	Maximum QSBS Rate	Maximum QSBS AMT Rate	Maximum Rate (No QSBS)
Aug. 11, 1993 to Feb. 17, 2009	50%	15.90%	16.88%	23.80%
Feb. 18, 2009 to Sep. 27, 2010	75%	7.95%	9.42%	23.80%
After Sep. 27, 2010	100%	0.00%	0.00%	23.80%







# House Ways & Means Proposed Amendment

## 1202(a)—Exclusion

(1) In General — In the case of a taxpayer other than a corporation, gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than 5 years.

\*\*\*

(3) Special Rules For 2009 And Certain Periods In 2010 — In the case of qualified small business stock acquired after the date of the enactment of this paragraph and on or before the date of the enactment of the Creating Small Business Jobs Act of 2010 [September 27, 2010]—

(A) paragraph (1) shall be applied by substituting “75 percent” for “50 percent”

\*\*\*

(4) 100 Percent Exclusion For Stock Acquired During Certain Periods In 2010 And Thereafter — In the case of qualified small business stock acquired after the date of the enactment of the Creating Small Business Jobs Act of 2010 [September 27, 2010]—

(A) paragraph (1) shall be applied by substituting “100 percent” for “50 percent”,

\*\*\*

(C) paragraph (7) of section 57(a) shall not apply.

(5) LIMITATION ON CERTAIN SPECIAL RULES.—In the case of the sale or exchange of qualified small business stock after September 13, 2021, paragraphs (3) and (4) shall not apply to any taxpayer if—

(A) the adjusted gross income of such taxpayer (determined without regard to this section and sections 911, 931, and 933) equals or exceeds \$400,000, or

(B) such taxpayer is a trust or estate.

**Could this provision be unconstitutional under the Due Process Clause?**



## If House Ways & Means Provisions Are Enacted...

Acquisition Date or Taxpayer	Exclusion Percentage	Maximum QSBS Rate	Maximum QSBS AMT Rate	Maximum Rate (No QSBS)
Aug. 11, 1993 to Feb. 17, 2009 or Trusts, Estates & Individual Taxpayers with \$400,000 or more in AGI	50%	15.90%	16.88%	28.80%
Feb. 18, 2009 to Sep. 27, 2010 (Not Trust, Estate or HI Taxpayer)	75%	7.95%	9.42%	28.80%
After Sep. 27, 2010 (Not Trust, Estate or HI Taxpayer)	100%	0.00%	0.00%	23.80%





# Exclusion Percentage and Calculating Gain

\$100 Mil. (FMV)

**Non-  
Section 1202  
Gain**

**Excluded  
Section 1202  
Gain**

**Section 1202  
Gain**

**\$5 Mil. (Basis)**

50%  
Exclusion  
Percentage

*Per-Issuer  
Limitation  
\$50 Mil.  
(10 x Basis)*

***If stock had been acquired for appreciated  
property in tax free transaction ...***

**\$4 Mil.  
Built-In Gain**

**\$1 Mil. (Basis)**

**Non-  
Section 1202  
Gain**

Category Of Gain	Maximum Tax Rate	Amount Of Gain	Federal Tax Liability
Excluded Section 1202 Gain	0.00%	\$25 Mil.	\$0.00
Section 1202 Gain	31.80%	\$25 Mil.	\$7.95 Million
Non-Section 1202 Gain	23.80%	\$45 Mil.	\$10.71 Million
TOTALS	N/A	\$95 Mil.	\$18.66 Million



# “Per-Issuer Limitation”

- ❑ Prescribes the maximum gain that can be excluded (or partially excluded) each taxable year.
- ❑ **Each taxable year** shall not exceed the **GREATER** of:
  - ❖ \$10 million **reduced by aggregate eligible gain taken for prior taxable years** (\$10 Million Per Taxpayer Limitation); or
  - ❖ 10 times the aggregate **adjusted basis** of QSBS sold by the taxpayer **in the taxable year** (10 Times Basis Limitation).

## Quixotic Definition of “Adjusted Basis”:

- If taxpayer acquires QSBS through a contribution of property, “adjusted basis” shall **NOT be less than fair market value** at the time of contribution.
- “Adjusted basis” is determined **without** regard to any **addition** to basis after stock was originally issued to the taxpayer.

What about a “step-down” in basis?

## Quirky of Rules of Construction:

- Calculated each taxable year;
- \$10 Million Per Taxpayer reduced by previous eligible gain from prior years; and
- 10 Times Basis Limitation is **NOT** reduced by previous year (only the current year counts).

## Quibbling Question of Application?:

- ✓ **Is Per-Issuer Limitation applied against eligible gain first, followed by application of the Exclusion Percentage?**
- ✗ **Is Exclusion Percentage applied against eligible gain first, followed by the Per-Issuer Limitation?**

## Queechering Quagswag???:

§ 1202(i)(2) provides basis can be adjusted by reason of a “contribution to capital” after original issuance, providing for an upward adjustment of no less than the fair market value of any contributed property.





# Qualified QSBS Shareholders

Section 1202 exclusion is available to “a taxpayer other than a corporation” (Qualified QSBS Shareholder), including:

- Individual
- Trust
- Estate

Qualified QSBS Shareholders may benefit from the section 1202 exclusion if QSBS is held by a “Pass-Thru Entity,” including:

- Partnership
- S Corporation
- Regulated Investment Company
- Common Trust Fund

## Pass-Thru Entity Requirements:

*Partner, shareholder, or owner (who is a Qualified QSBS Shareholder) of a Pass-Thru Entity is entitled to section 1202 exclusion on gain that allocated to the taxpayer, if the eligible gain is:*

- *Attributable to a sale or exchange by the Pass-Thru Entity of stock which is QSBS in the hands of such entity (treating such entity as an individual) and which was held by such entity for more than 5 years; and*
- *Includible in the gross income of the owner “by reason of the holding of an interest in such entity which was **held by the taxpayer on the date** on which such pass-thru entity acquired such stock and **at all times thereafter** before the disposition of such stock.”*

## Pass-Thru Entity Benefit Limitations:

*Allocated gain subject to a partial or complete exclusion “shall not apply to any amount to the extent such amount exceeds the amount ... which ... would have applied if such amount were determined **by reference to the interest the taxpayer held in the pass-thru entity on the date the qualified small business stock was acquired.**”*



# QSBS Defined and the Original Issue Requirement

In order for stock to be considered Qualified Small Business Stock (QSBS), it must be:

- ☐ Stock in a C corporation;
- ☐ Issued after August 10, 1993;
- ☐ On the date of issuance, issued by a Qualified Small Business (QSB);
- ☐ Acquired by the taxpayer at its “original issue” (Original Issuance):
  - In exchange for money or other property (other than stock), or
  - As compensation for services provided to such corporation.

**“Original issue” refers to an issuance of stock directly from the corporation to a Qualified QSBS Shareholder, as opposed to an acquisition of such stock on the secondary market or from another person who acquired it at original issuance.**

**This requirement is meant to promote new investment in small business.**





# Original Issuance, Permitted Transfers, and Disqualifications

## Permissible Transfers:

*The Original Issuance requirement is not violated if taxpayer receives:*

- ☐ “By gift”,
- ☐ “At death,” or
- ☐ In a transfer from a partnership to a partner.

- “By gift” and “at death” are NOT defined.
- Transfer from an S corporation to a shareholder is NOT a permissible transfer.
- Contribution from a partner to a partnership is NOT included, but can it be remedied?

## Disqualifying Corporate Redemptions/Purchases:

❖ Any purchase from taxpayer (or related person)

**Disqualifies all stock held by the taxpayer.**

Original Issuance

-2 years

+2 years

### Exceptions:

- De Minimis Amounts:
  - \$10,000, and
  - >2% of taxpayer/corporation.
- Certain purchases involving:
  - Service providers, and
  - Death of acquiring taxpayers.

❖ Significant purchase (>5% aggregate stock of corporation)

**Disqualifies all stock of the corporation.**

Original Issuance

-1 year

+1 year





# Eligible Gain: 5-Year Holding and Tacking

## Eligible Gain:

The section 1202 exclusion and the Per-Issuer Limitation is applied against “**eligible gain**” which is:

- Any gain from the sale or exchange of QSBS
- Which has been held by the taxpayer for more than 5 years.

## Tacking:

*“Tacking” of transferor’s holding period to the transferee allowed with Permissible Transfers:*

- “By gift”,
- “At death,” or
- In a transfer from a partnership to a partner.

*“Tacking” also available with:*

- Corporate conversions,
- Tax-Free Exchanges (E.g., Sections 351 and 368), and
- Section 1045 Rollover.

## Disqualifying Hedging Transactions:

*If taxpayer (or related party) has “**offsetting short position**” (short sale, option to sell at a fixed price, or any other transaction that substantially reduces the risk of loss) on any QSBS, gain will not qualify for exclusion unless:*

- Taxpayer held for more than **5 years** on first day of the short position, and
- Taxpayer **elects to recognize gain** as if the stock was sold at fair market value on that day.





## Section 1045 Rollover

Taxpayer may defer recognition of gain on the sale of QSBS if:

- Original QSBS has been held by the taxpayer for **more than 6 months**;
- Taxpayer makes an **election** to apply section 1045 to the sale; and
- Replacement QSBS is acquired **within 60 days** of the original sale.

Replacement period for QOZ Fund deferral is 180 days.

Query whether QOZ Fund investments can be combined with QSBS to eliminate deferred capital gain.

### Important Planning Considerations:

- Taxpayer has the option to elect rollover for each sale, if there is more than one sale of QSBS in a year.
- Applies based on the amount of sale proceeds used to acquire replacement stock.
- Separate lot accounting is critical to maximize deferral (otherwise first-in, first-out).
- Basis in the replacement QSBS is applied “in the order acquired.”

Can rollover be used to create multiple new \$10 Million Per Taxpayer Exclusions?

### Partnership Treasury Regulations:

*In 2007, very detailed guidance was issued on the availability of section 1045 rollover to partnerships and their eligible partners*

- Allows three different methods of rollover, with elections that can be made by the partnership or by the partners. Replacement QSBS can be purchased by the partnership or the partners.
- Deferral of gain is limited by the **Nonrecognition Limitation**, defined as:
  - Partnership realized gain from the sale of QSBS, multiplied by
  - Eligible partner’s “**smallest percentage in partnership capital**” determined “**at the time of acquisition**” of the original QSBS.





# Qualified Small Business (QSB) Defined

“Qualified Small Business” (QSB) is:

- Domestic C corporation
- That meets the “**Aggregate Gross Asset Requirement**”
- That also “agrees to submit such **reports** to the Secretary and to shareholders as the Secretary **may require**.”

Aggregate Gross Asset Requirement:

- “**At all times**” on or after August 10, 1993,
- **Before** the issuance of stock,
- **Immediately after** issuance,
- “**Aggregate Gross Assets**” do NOT exceed **\$50 million**.

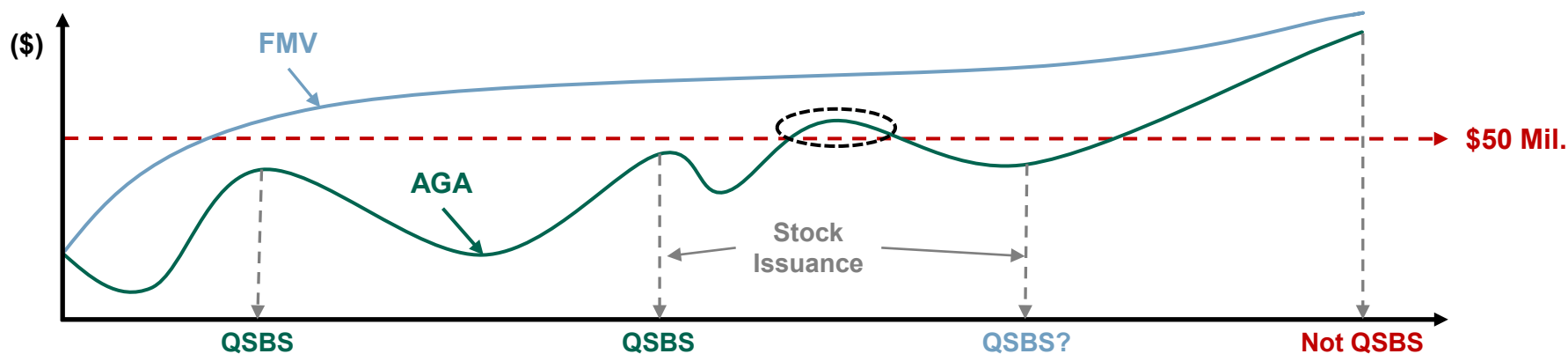
Does “at all times” mean every day? Does it suffice that on average or at the end of each fiscal year the \$50 million threshold is met?

What types of records are to required to prove that the Aggregate Gross Asset Requirement is met?

Treasury has not published any reporting requirements to be considered a QSB. Can IRS require unreasonable reports during an examination and conclude QSB requirements are not met?

## Quixotic Definition of “Aggregate Gross Assets”:

- Liabilities are ignored.
- Amount of cash and the **aggregate adjusted bases** of property held by the corporation.
- Adjusted basis of **contributed property** is deemed to be the **fair market value** at the time of contribution.





# QSBS: Active Business Requirement

Stock will not be considered QSBS unless

- “During **substantially all** of the taxpayer’s **holding period**,” the corporation meets
- the “**Active Business Requirement**”

Active Business Requirement:

- At least **80 percent** (by value) of all of the assets are “in the **active conduct** of 1 or more **qualified trades or businesses**” (80 Percent Test); and
- Corporation is an “eligible corporation” (**domestic corporation**, with certain exceptions).

“Substantially all” is NOT defined.

Applies only to taxpayer’s holding period.

No guidance on how “substantially all” applies in conjunction with the 80 Percent Test.

QOZ Treasury guidance helpful?

## 80 Percent Test:

- *No guidance as to whether this must be met at all times, on average, or at the end of each year.*
- **Parent-Subsidiary** (50% or more) look-through rule.
- *Deemed to fail if >10 percent of assets consist of **real property not used in the active conduct** of the trade or business.*
- *Deemed to fail if **10 percent** or more of assets in **stocks or securities** of non-subsidiary corporations.*
- *Exceptions and special rules for:*
  - **Working capital** operating needs and for research/experimentation of the trade or business.
  - Assets needed for **start-up** activities and certain deductible **research and experiment** expenses.

## Qualified Trade or Business:

*Defined by negation (see Venn Diagram). See section 199A regulations regarding specified service trades or businesses.*



# C Corporation Formation or Conversion

Formation of C corporation under section 351

- No gain or loss on transfer of property in exchange for stock in the corporation if
- Immediately after, transferors are in “control” (at least 80 percent of stock).

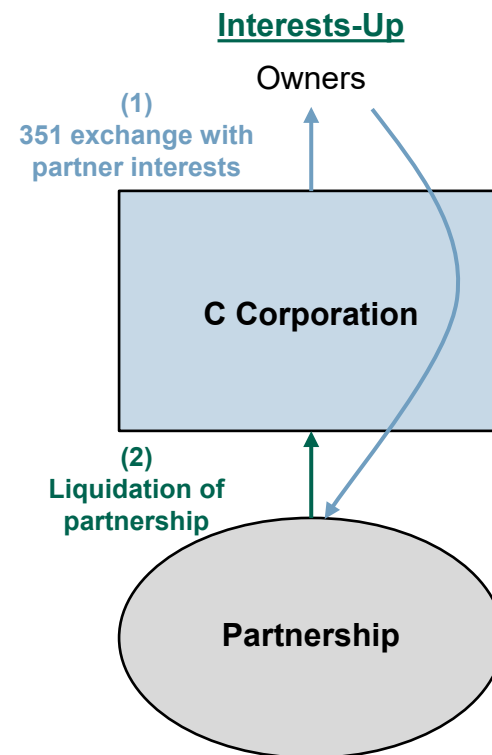
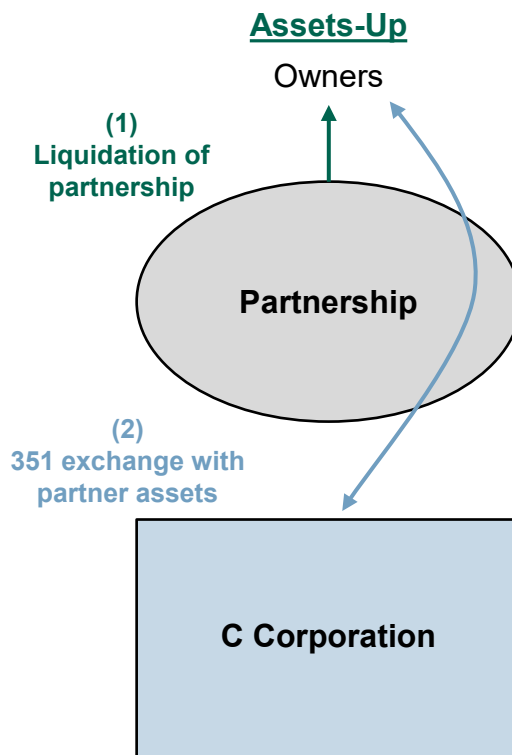
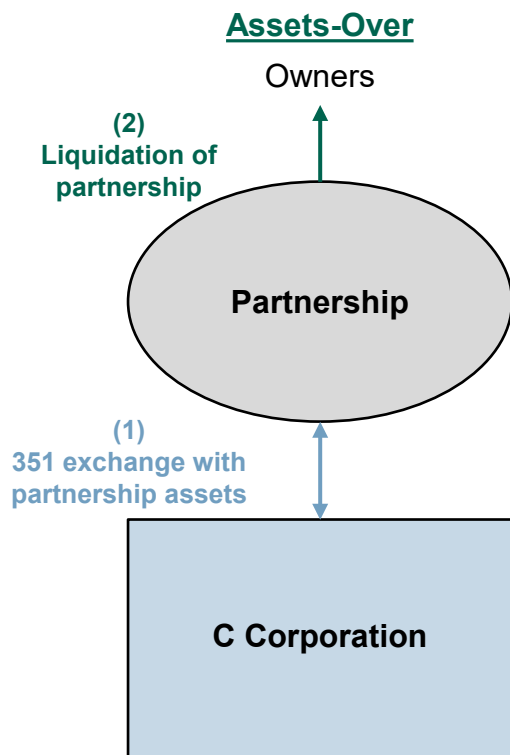
Methods of converting partnership (incl. LLC, taxed as) to C corporation:

- “**Assets-Over**”
- “**Assets-Up**”
- “**Interests-Up**”
- **Check-the-box** election (treated as “Assets-Over” for tax purposes)

Each method of conversion results in different basis in corporate shares and different “inside basis” for corporation.

No separate lot accounting of basis.

10 Times Basis Limitation & Aggregate Gross Assets are calculated, in part, by basis.





# QSBS: Reporting, State Income Tax, Etc.

## Federal Reporting

- ☐ Section 1202 is NOT elective
- ☐ QSB corporations currently have no reporting requirements.
- ☐ QSBS shareholders report sales on Schedule D and Form 8949.
  - Exclusion is reported as a negative number.
  - 28% Rate Gain Worksheet
  - Special instructions for installment sales.
- ☐ IRS has held that gain excluded under section 1202 may not be used to extend the assessment period to 6 years.

## State Income Tax Treatment:

- *Large proportion of states follow federal treatment of QSBS (or do not have an income tax).*
- *Some states (e.g., CA and PA) completely disallow the QSBS exclusion.*
- *Some states (e.g., MA, NJ, and HI) make modifications to the QSBS exclusion.*





# Transfers “By Gift,” “At Death,” and Others

## Defining Transfers “By Gift” and “At Death”:

- ☐ Income Tax Definition, Not Transfer Tax
- ☐ Transfers “By Gift”:
  - Recognized for income tax purposes but is not a taxable sale or exchange
  - Results in a different taxpayer as transferee
  - Transferee’s basis is determined under section 1015
- ☐ Transfers “At Death”
  - Recognized for income tax purposes but is not a taxable sale or exchange
  - Results in a different taxpayer as transferee
  - Transferee’s basis is determined under section 1014

QOZ Proposed Regulations define transfers “by gift” similarly (including changes in grantor trust status) as “inclusion events” and disregard “contributions” to grantor trusts

Transfer resulting from the exercise of a general or limited power of appointment is considered a transfer “by gift.”

## Transfers Related to Partnerships

- ☐ Transfer of QSBS from a partnership to a partner is a permissible transfer
- ☐ Contribution of QSBS by a partner to a partnership is NOT a permissible transfer
- ☐ Gratuitous transfer of interest in a partnership that holds QSBS
  - Section 1202: “**held by the taxpayer**” at the time of acquisition and “**at all times thereafter before disposition.**”
  - Section 1045 regulations: transfer by gift or at death, transferee treated as having held partnership interest during the period the transferring partner held it.
- ☐ Transfers related to wholly-owned (disregarded) entities



## Movement of QSBS Shares: Transfers “By Gift”

Description of Transfer	Status Retained?	Additional Per-Issuer?
Gift to individual	Yes	Yes
Contribution to non-grantor trust	Yes	Yes
Contribution to incomplete gift non-grantor trust (i.e., DING or NING)	Yes	Yes
Distribution from non-grantor trust to a beneficiary	Yes	Yes
Distribution from grantor trust to a beneficiary (other than grantor)	Yes	Yes
Distribution (or decanting) from grantor or non-grantor trust to another non-grantor trust (considered a separate taxpayer)	Yes	Yes
Splitting pot trust into separate trusts for separate beneficiaries	Yes	Yes
Transfer on exercise of a general or limited power of appointment	Yes	Yes
Expiration of GRAT term to non-grantor trust or individual (not grantor)	Yes	Yes
Gift to spouse who is filing separately	Yes	<b>No</b>
Gift to spouse who is filing jointly	Yes	<b>Yes</b>
Transfer incident to a divorce	Yes	Yes
Contribution to CRT	Yes	Unknown
Contribution to non-grantor CLT	Yes	Yes





## Movement of QSBS Shares: Ignored Transfers

Description of Transfer	Status Retained?	Additional Per-Issuer?
Contribution to revocable trust	Yes	No
Taxable gift to IDGT	Yes	No
Contribution to GRAT	Yes	No
Transfer to grantor from GRAT in satisfaction of annuity payment	Yes	No
Expiration of GRAT term to a grantor trust	Yes	No
Sale to IDGT in exchange for installment note	Yes	No
Transfer to grantor in satisfaction of installment note debt held by grantor	Yes	No
Contribution to grantor CLT	Yes	No





## Movement of QSBS Shares: Entity-Related Transfers

Description of Transfer	QSBS Treatment	Status Retained?	Additional Per-Issuer?
Contribution to FLP	<b>Unknown</b>	<b>Unknown</b>	<b>Unknown</b>
Distribution from FLP to partner	Permitted	Yes	No
Contribution to disregarded entity	Ignored	Yes	No
Gift of interest in FLP to individual or non-grantor trust	<b>Unknown</b>	<b>Unknown</b>	<b>Unknown</b>
Gift of FLP interest to GRAT or IDGT	Ignored	Yes	No
Sale of FLP interest to IDGT in exchange for promissory note	Ignored	Yes	No
Contribution to S corporation	Disqualifying	No	No
Distribution from S corporation	Disqualifying	No	No
Gift of interest in S corporation to individual or non-grantor trust	<b>Unknown</b>	<b>Unknown</b>	<b>Unknown</b>
Gift of S corporation to GRAT or IDGT	Ignored	Yes	No
Termination of GRAT with FLP interest passing to grantor trust	Ignored	Yes	No
Conversion of disregarded LLC to partnership	<b>Unknown</b>	<b>Unknown</b>	<b>Unknown</b>
Conversion of partnership or S corporation to C corporation	Disqualifying	No	No
Exchange under Sections 351 or 368	Permitted	Yes	No



## Movement of QSBS Shares: Other Transfers

Description of Transfer	QSBS Treatment	Status Retained?	Additional Per-Issuer?
Termination of grantor trust status	By gift	Yes	Yes
Termination of grantor trust status with debt in excess of basis	By gift & Disqualifying	Yes & No	Yes & No
Conversion of non-grantor trust to grantor trust	Ignored	Yes	No
Conversion of non-grantor trust to grantor trust with debt in excess of basis	Ignored	Yes	No
Bequest of QSBS	By death	Yes	Yes
Transfer to survivor from joint account	By death	Yes	Yes
Distribution from revocable trust upon death of grantor	By death	Yes	Yes



# Getting Both Per-Issuer Limitations

- ☐ Prescribes the maximum gain that can be excluded (or partially excluded) each taxable year.
- ☐ **Each taxable year** shall not exceed the **GREATER** of:
  - ❖ \$10 million **reduced by aggregate eligible gain taken for prior taxable years** (\$10 Million Per Taxpayer Limitation); or
  - ❖ 10 times the aggregate adjusted basis of QSBS sold by the taxpayer **in the taxable year** (10 Times Basis Limitation).

## Rules of Construction:

- Calculated each taxable year;
- \$10 Million Per Taxpayer reduced by previous eligible gain from prior years; and
- 10 Times Basis Limitation is NOT reduced by previous year (only the current year counts).

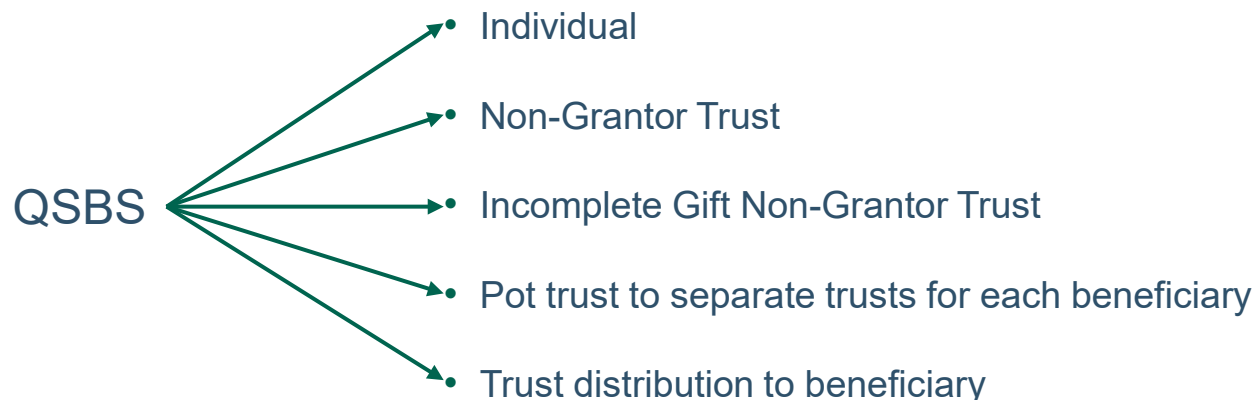
## Ordering QSBS Sales:

- *Utilize multiple taxable years*
- *Sell 100% Exclusion Percentage QSBS before 75% and 50% QSBS*
- *Sell lowest basis QSBS first to utilize the \$10 Million Per Taxpayer Limitation*
- *Consider selling multiple lots to maximize the “aggregate” cost basis for the 10 Times Basis Limitation*
- *Take advantage of “stacking” (multiplying) the Per Issuer Limitation to other taxpayers*



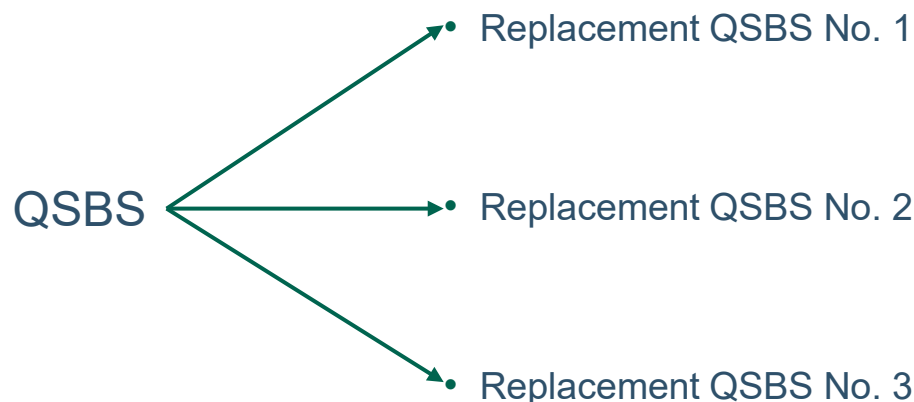
## “Stacking” the Per-Issuer Limitation

### ❖ Stacking (Multiplying) the \$10 Million Per Taxpayer Limitation with “by gift” transfers



**Caveat:**  
**§ 643(f) “Multiple Trust”**  
**Treasury Regulations**

### ❖ Creating New \$10 Million Per Taxpayer Limitation with section 1045 rollover

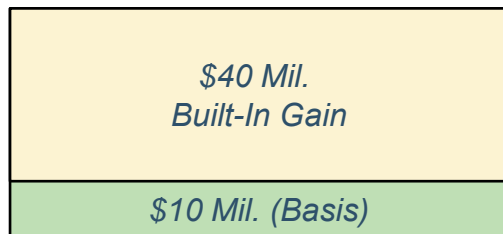


**Per-Issuer Limitation is**  
**based upon the stock**  
**“issued by such corporation.”**



## “Packing” the Per-Issuer Limitation

- ❖ Packing (Maximizing) the 10 Times Basis Limitation with contributions of property



**$\times 10 = \$500 \text{ Million Per-Issuer Limitation}$**

- ❖ Packing the 10 Times Basis Limitation with non-eligible gain

### 10 Times Basis Limitation Defined

“10 times the aggregate adjusted bases of qualified small business stock issued by such corporation and disposed of by the taxpayer during the taxable year.”

**NOT defined in terms of QSBS eligible gain (5-year holding period) of the taxable year.**

Exercise option to purchase  
\$4 million for \$1 million QSBS  
(\$3 million of ordinary income)

+

(Non-Eligible Gain)  
Sell option-acquired  
QSBS stock for  
nominal gain

+

(Eligible Gain)  
Sell \$0 basis QSBS  
held for more than 5 years for  
\$40 million of gain

=

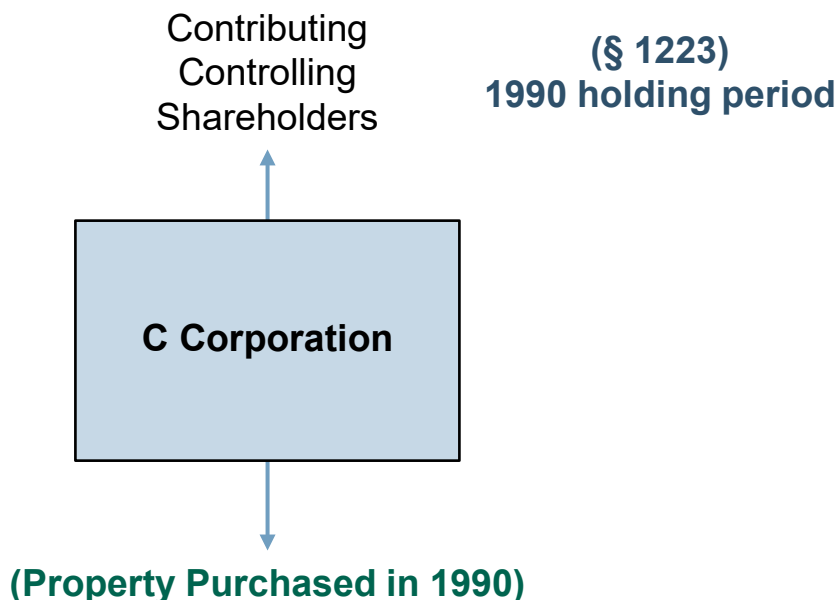
**\$40 Million  
Per-Issuer Limitation**



# QSBS and Pre-Existing Businesses

## The “Flush” Language

“In the case of any stock which would be described in the preceding sentence (but for this sentence), the acquisition date for purposes of this subsection shall be the first day on which such stock was held by the taxpayer determined after the application of section 1223.” §§ 1202(a)(3) and 1202(a)(4).



**“In the case where the taxpayer transfers property (other than money or stock) to a corporation in exchange for stock in such corporation, such stock shall be treated as having been acquired by the taxpayer on the date of such exchange.”  
§ 1202(i)(1)(A).**

## Legislative History

- Flush language only applies for section 1045 rollover purposes.
- “The provision is not intended to change the acquisition date determined under Section 1202(i)(1)(A) for certain stock exchanged for property.”

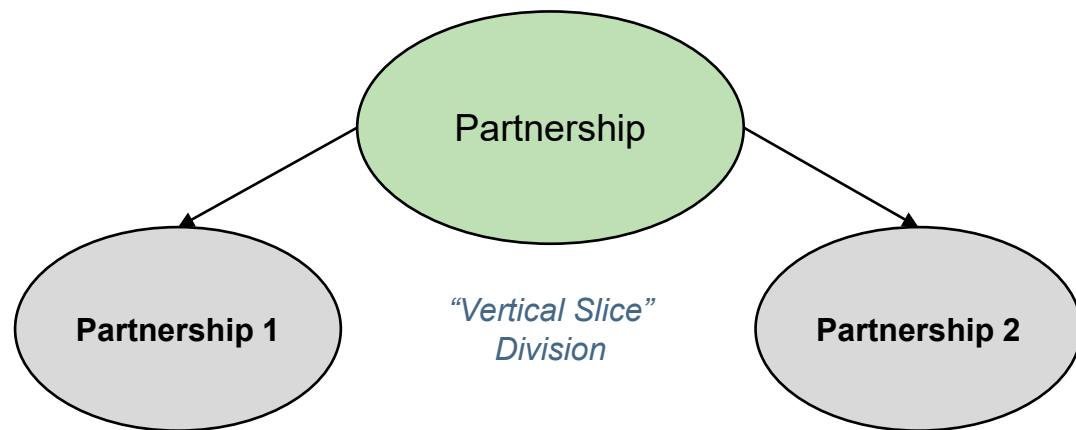




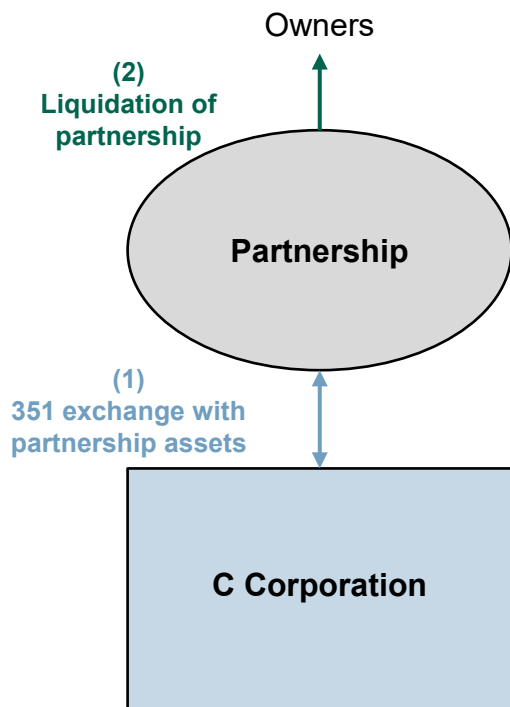
# Partnership Division and C Corporation Conversion

## Anti-Abuse Consideration

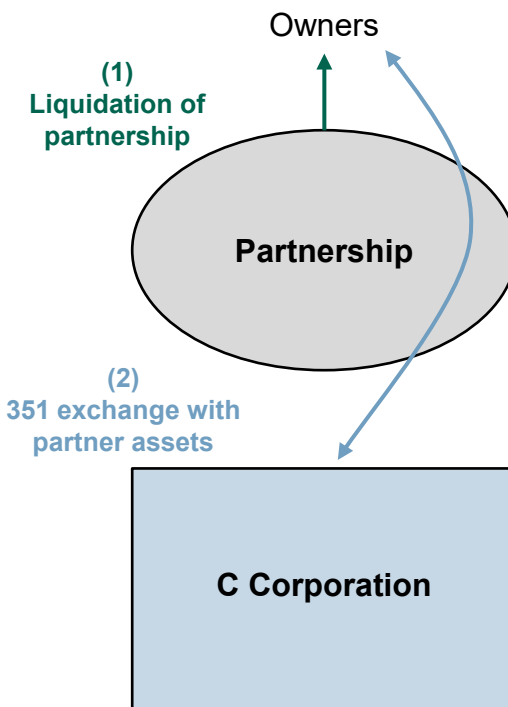
*"The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of this section through split-ups, shell corporations, partnerships, or otherwise."*



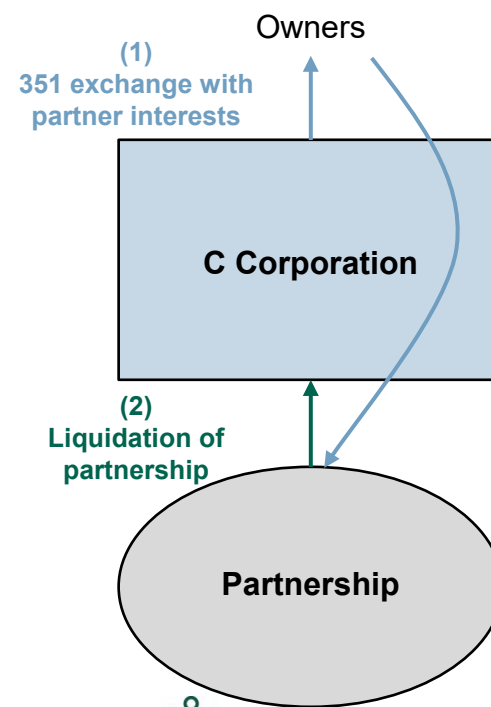
## Assets-Over



## Assets-Up

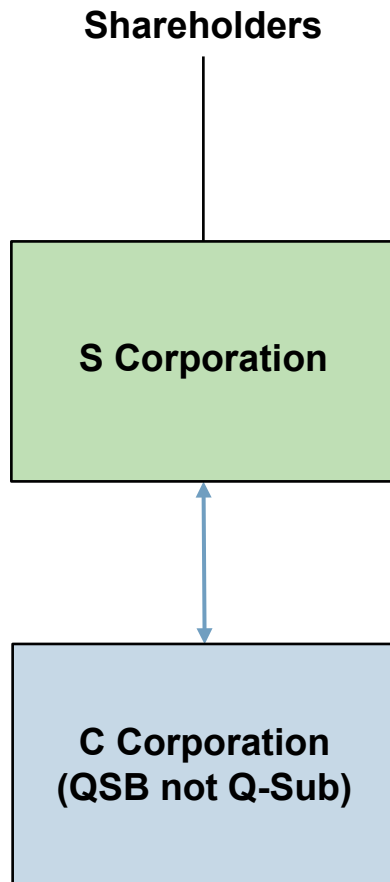


## Interests-Up





# QSBS and S Corporations

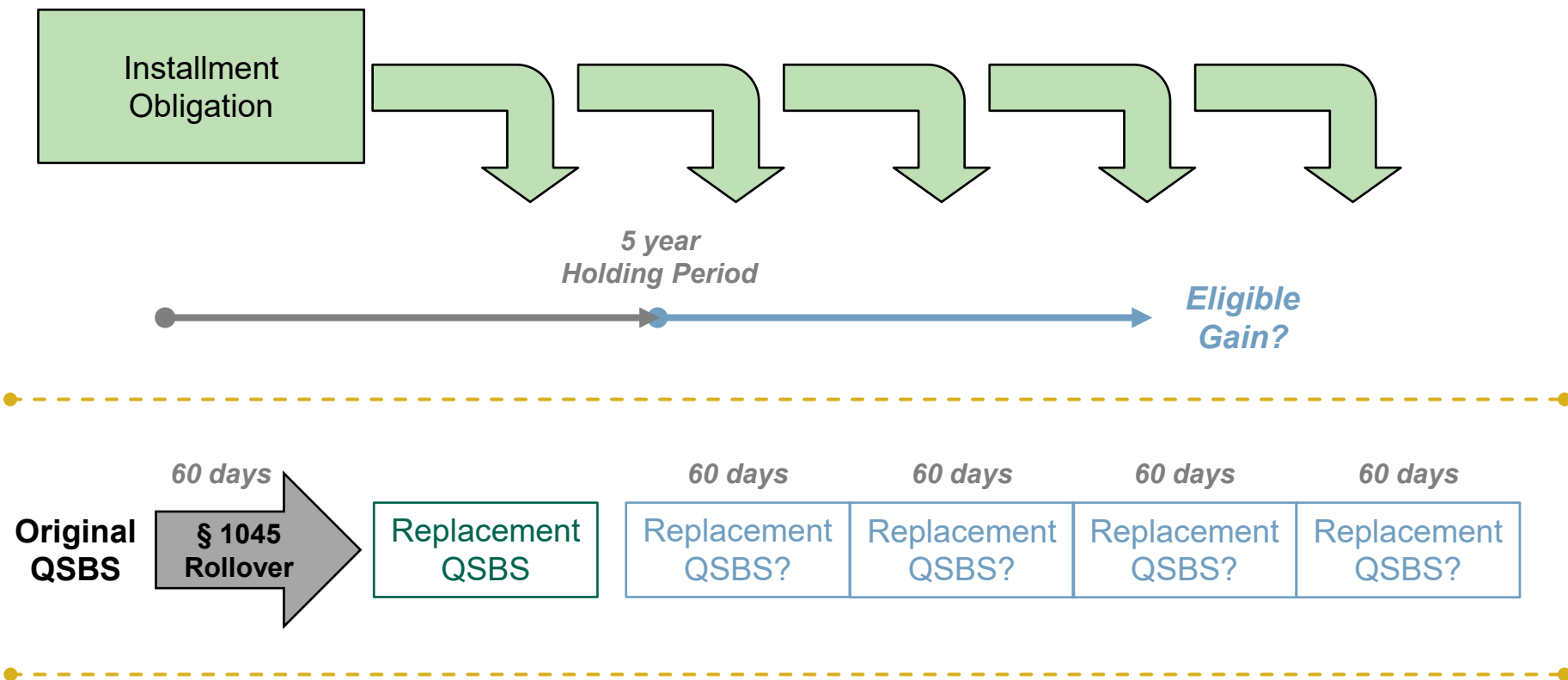


- ☐ Original Issuance (i.e., C corporation) requirement likely prevents S corporation from issuing QSBS even if QSBS “substantially all” requirement is met.
- ☐ C corporation that temporarily converts to an S corporation may still be able to claim QSBS status because QSBS “substantially all” requirement is still a possibility.
- ☐ Original shareholders of a corporation that originally started as an S corporation will not be able to claim QSBS, but subsequent issuances after converting to a C corporation may qualify as QSBS.
- ☐ Parent-subsidary limitation of Aggregate Gross Asset Requirement (i.e., \$50 million) may limit ability of pre-existing business to create non-Q-Sub QSB.
- ☐ One option is a tax-free division under section 355.





# Queries: Installment Sales, QSBS, and 1045 Rollovers



## Schedule D Instructions

Year 1  
\$10 Mil.

Year 2  
\$4 Mil

## Excluded Section 1202 Gain

(\$7.1 Mil.) (\$2.9 Mil.)

VS.

## Installment Sale Gross Profit Ratio

Year 1  
\$10 Mil.

Year 2  
\$4 Mil

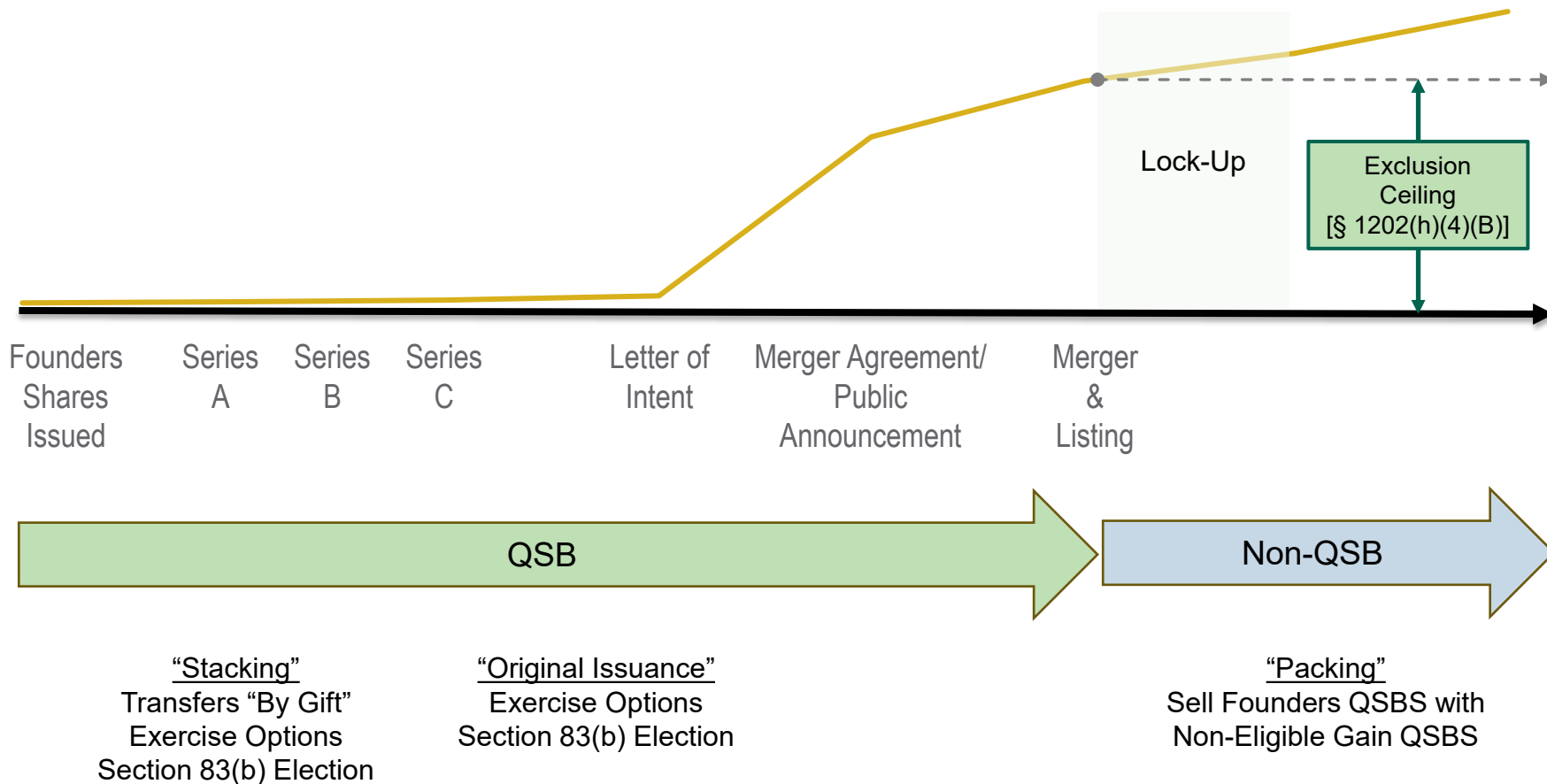
## Excluded Section 1202 Gain

(\$10 Mil.) (\$0.0 Mil.)



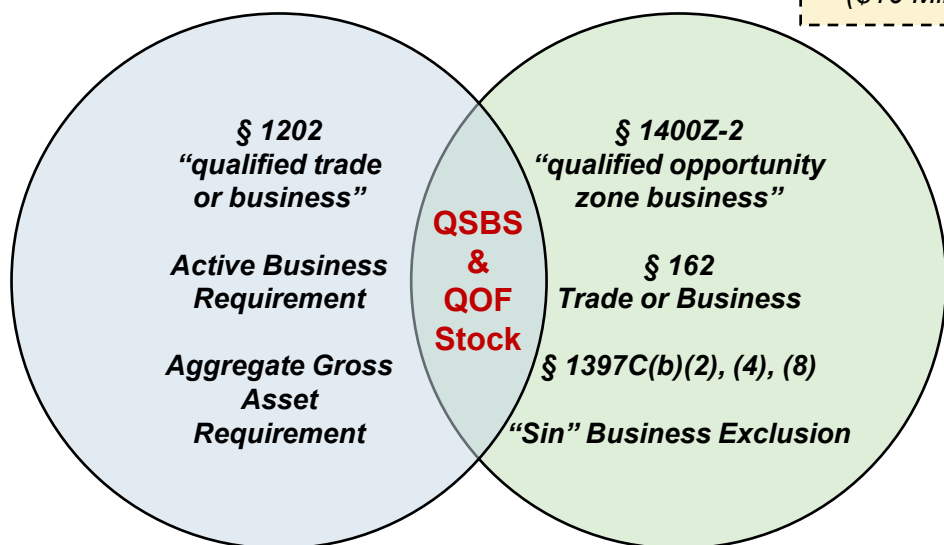
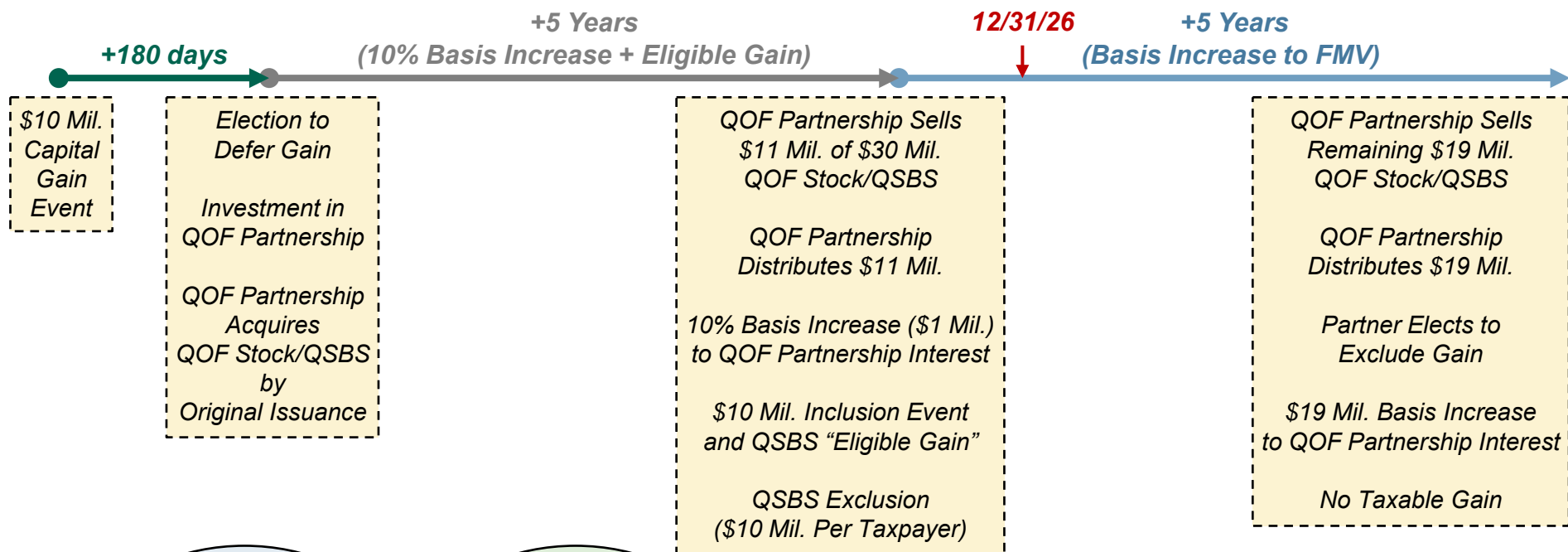
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# Planning to Stack and Pack Those SPACs?





# QSBS and QOZ: Can You Get Both Benefits?



**Inclusion Event that is a sale or exchange required for QSBS & QOZ purposes**

**Distribution in excess of basis of partnership interest is a sale or exchange under 721(a)**

**12/31/26 Inclusion is NOT a sale or exchange**

**Partnership distribution inclusion event NOT subject to "portion" rule**



# QSBS and Carried Interest

Section 1202 benefits with a pass-thru entity:

- Limited by the interest “**held by the taxpayer** on the date on which such **pass-thru entity acquired such stock**,” and
- May not exceed that amount that would have been excludable “**by reference to the interest the taxpayer held** in the pass-thru entity **on the date the qualified small business stock was acquired**.”

## Revenue Procedure 93-27:

- *Capital interest is based on proceeds received upon complete liquidation. Profits interest is an interest other than a capital interest.*
- *If person receives a profits interest for providing services to or for the benefit of a partnership in a partner capacity or in anticipation of becoming a partner, the receipt of the interest is not a taxable event for the partner or the partnership.*

## Revenue Procedure 2001-43

- “Where a partnership grants an interest in the partnership that is **substantially nonvested** to a service provider, the service provider will be treated as **receiving the interest on the date of grant**,” provided:
  - *Partnership and service provider treat service provider as the owner of the partnership interest from the date of its grant and service provider takes into account the distributive share of partnership income for the entire period the service provider has the interest.*
  - *On the date of grant of the interest or when it becomes substantially vested, neither the partnership nor any partner deducts any amount for the fair market value of the interest.*

## 2007 Partnership Section 1045 Treasury Regulations:

Deferral of gain is limited by the **Nonrecognition Limitation**, defined as:

- *Partnership realized gain from the sale of QSBS, multiplied by*
- *Eligible partner’s “**smallest percentage in partnership capital**” determined “**at the time of acquisition**” of the original QSBS.*



# Married Filing Separately or Jointly

☐ **Each taxable year** shall not exceed the **GREATER** of:

- ❖ \$10 million **reduced by aggregate eligible gain taken for prior taxable years** (\$10 Million Per Taxpayer Limitation); or
- ❖ 10 times the aggregate adjusted basis of QSBS sold by the taxpayer **in the taxable year** (10 Times Basis Limitation).

- Section 1202(b)(3)(A):

In the case of a **separate return** by a married individual, the \$10 Million Per Taxpayer Limitation shall be applied by substituting “\$5,000,000” for “\$10,000,000”

- Section 1202(b)(3)(B):

In the case of any **joint return**, the amount of eligible gain taken into account **shall be allocated equally between the spouses** for purposes of applying this subsection to subsequent taxable years.

- *“The term ‘taxpayer’ means any person subject to any internal revenue tax.” § 7701(a)(14).*
- *“If a joint return is made, the tax shall be computed on the aggregate income and the liability with respect to such tax shall be joint and several.” § 6013(d)(3).*
- *“It is a long recognized legal maxim that a husband and wife are **separate and distinct taxpayers notwithstanding the fact that they have filed joint Federal income tax returns.**” Nell v. Commissioner, T.C. Memo. 1982-228.*
- TAM 9853002
  - *Taxpayer and spouse are not considered a single taxpayer for purposes of the \$5 million limitation of section 453A.*
  - *“In particular, if Congress had intended that married individuals be treated as one taxpayer for purposes of apply the \$5,000,000 limitation..., it could have easily provided for this attribution in express terms... Where Congress is silent on this point, as in section 453A, we do not believe that an allocation between married individuals can be implied.”*
  - *Taxpayer and spouse filed separately.*



# Charitable Planning and the Basis Adjustment at Death

\$100 Mil. (FMV)

**Non-  
Section 1202  
Gain**

**Excluded  
Section 1202  
Gain**

**Section 1202  
Gain**

**\$5 Mil. (Basis)**

50%  
Exclusion  
Percentage

*Per-Issuer  
Limitation  
\$50 Mil.  
(10 x Basis)*

## Consider for Charity & Basis Adjustment

- Very low adjusted tax basis
- 50% or 75% Exclusion Percentage
- Significant unrealized Non-Section 1202 Gain
- Less than 5 year holding period stock

**“Step-down” in basis may not affect 10 Times Basis Limitation**

***If stock had been acquired for appreciated  
property in tax free transaction ...***

**\$4 Mil.  
Built-In Gain**

**\$1 Mil. (Basis)**

**Non-  
Section 1202  
Gain**



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