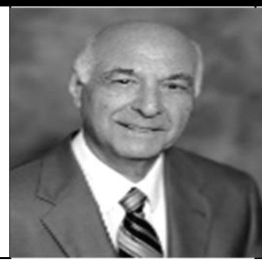
Financial, Legal & Tax Advisory

Published by The Center for Financial, Legal & Tax Planning, Inc. 01/2023

Roman A. Basi, President of The Center, is an Attorney, CPA, Real Estate Broker, and Title Insurance Agent. Roman speaks and advises The Center's clientele on such matters as Business Law, Succession, Estate & Tax Planning, and Real Estate.



Dr. Bart A. Basi, Senior Advisor of the Center for Financial, Legal & Tax Planning, Inc., is an expert on closely-held companies, an attorney, and CPA. He is a member of the American Bar Association's Tax Committees on Closely-Held Businesses and Business Planning.

Section 1202: Small Business Stock Capital Gains Exclusion

Selling your business? What if I told you that you could exclude up to $10 Million from the sale of your business if you meet certain parameters. It is important business owners take note of the requirements as they are very important to qualify for the exclusion. Section 1202 of the Internal Revenue Code is a very beneficial tool and the exclusion and easily be applied to your sale. Section 1202 is known as the Small Business Stock Capital Gains Exclusion. This section can only be applied to qualified small business stock acquired after September 27, 2010, that is held for more than five years.

Within the Protecting Americans from Tax Hikes (PATH) Act in 2015, one tax benefit, made permanent by the Obama administration, was the Small Business Stock Capital Gains Exclusion found in Section 1202. The intention of this section in the Internal Revenue Code was to provide an incentive for non-corporate taxpayers to invest in small businesses in the United States. Before February 18, 2009, Section 1202 allowed up to 50% of capital gains to be excluded from gross income.

The American Recovery and Reinvestment Act then increased the exclusion rate from 50% to 75% for stock purchased between February 18, 2009, and September 27, 2010. This was done to stimulate the small business sector. The latest revision to Section 1202, where we are today, provides for 100% exclusion of any capital gain if the small business stock was acquired after September 27, 2010.

The capital gains exempt from tax are also exempt from the net investment income (NII) tax applied to most investment income at a rate of 3.8%. The limit upon the amount of gain a shareholder can exclude is limited to either $10 Million or 10 times the adjusted basis of the stock. Any taxable portion of the gain from selling small business stock has an assessment at the maximum tax rate of 28%. Keep in mind, not all small business stocks qualify for this tax break. Some very stringent requirements must be followed regarding small business stock. These requirements are:

1. It was issued by a domestic C-corporation other than a hotel, restaurant, financial institution, real estate company, farm, mining company, or business relating to law, engineering, or architecture.

a. Can also be applied to an LLC taxed as a C-Corporation.

2. It was originally issued after Aug. 10, 1993, in exchange for money, property not including stocks, or as compensation for a service rendered.

3. On the date of the stock issue and immediately after, the issuing corporation had $50 million or less in assets.

4. The use of at least 80% of the corporation's assets is for the active conduct of one or more qualified businesses.

5. The issuing corporation does not purchase any of the stock from the taxpayer for four years beginning two years before the issue date.

6. The issuing corporation does not significantly redeem its stock within two years beginning one year before the issue date. A significant stock redemption is redeeming an aggregate value of stocks that exceed 5% of the total value of the company's stock.

If you own a business that satisfies these requirements, then start celebrating. Whenever you go to sell your business, you should be able to exclude all or almost all your federal capital gains tax. Keep in mind that state taxes differ from federal taxes. If your state taxes conform to federal taxes, you could also exclude capital gains from your state taxes. Since all states do not correlate directly, taxpayers should seek guidance on how their states will treat the gain from the sale of qualified small business stock.

Business owners must check immediately with their business broker, accountant, or legal counsel regarding their business structure. This is especially true for those who plan to sell within the next couple of years. If you are looking into selling your business and have any questions about the Small Business Stock Capital Gains Exclusion, reach out to the professionals at The Center for Financial, Legal, and Tax Planning, Inc at our website, www.taxplanning.com or by phone at (618) 997-3436.

FIND US
ONLINE

Facebook: @taxplanningatthecenter

Twitter: @_TaxPlanning

www.taxplanning.com