Montgomery & Hansen LLP

New 100% Qualified Small Business Stock Exclusion

Temporary Exclusion of Gain from Qualified Small Business Stock Acquired by December 31, 2010

The Small Business Job Creation and Access to Credit Act of 2010, signed into law on September 27, 2010, created a temporary exclusion for 100% of the gain on Qualified Small Business Stock (QSBS) if the investment is made by year end. Alternative minimum tax (AMT) is also 100% excluded. After January 1, 2011, the gain exclusion will revert to 50% with a portion being a preference under AMT. Below are some of the specifics:

- The investor cannot be a corporation.
- Investor must acquire stock in a C corporation. Convertible notes, warrants and options do not count. However, QSBS stock acquired by conversion of notes or exercise of options and warrants *should* qualify, depending on the circumstances.
- The investor must hold the stock for more than five years.
- Gross assets of the company cannot exceed $50 million either prior to the investment or immediately after the investment.
- For substantially all of the investor's holding period, 80% of the company's assets must be used in the active conduct of a qualified business or certain research and experimental activities. Most non-service businesses qualify.
- The exclusion will not apply if the company has redeemed certain amounts of its stock or the investor's stock.
- The qualifying gain is generally limited to the greater of $10 million or 10 times the basis in the stock.
- The exclusion applies to federal taxes. California law has similar exclusions for a portion of QSBS gain, which includes additional limitations and requirements.

The tax code and regulations governing this exclusion are complicated and depend on the circumstances. Be sure to consult with your tax advisors if you desire to take advantage of them. Do not rely on the summary above.

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