



Tax Alert

June 2009

Tax Eliminated on Gains from Small Business Stock

The Obama Administration has proposed sweeping changes to numerous parts of the country's income tax regime. This Tax Alert is the first in a series to outline selected proposals that will be of interest to our clients.

How the current law works:

Under the current rules, non-corporate taxpayers can exclude from income 50% of the gain recognized from the sale of small business stock, which is held for at least 5 years. Recently enacted legislation increased this exclusion to 75% for small business stock acquired after February 17, 2009 and before January 1, 2011. The taxable portion of the gain is subject to a 28% tax rate, and some of the excluded portion is treated as a preference item under the alternative minimum tax ("AMT") regime.

The amount subject to exclusion is limited to the greater of: (1) 10 times the taxpayer's basis in the stock issued by the corporation and disposed of during the year, or (2) \$10 million reduced by gain excluded in prior years' dispositions. Small business stock is stock of a C corporation engaged in an "active" trade or business whose gross assets, when the stock is issued, total \$50 million or less. An "active" trade or business excludes, among other commercial activities, most professional services, banking, insurance, leasing, investing, farming, hospitality, and ownership of, dealing in, or renting real property.

How the proposal works:

Due to the application of a 28% tax rate on the taxable portion of the gain, and the AMT impact, the current 50% exclusion, in reality provides little benefit. With the goal of encouraging and rewarding new investments in qualified small business stock, the proposal increases the exclusion to 100% and the AMT preference is eliminated. The current rules defining a qualifying small business, requiring a 5-year holding period, and applying the exclusion "ceiling," still apply under the proposal. The 100% exclusion would be effective for qualified small business stock issued after February 17, 2009.

If you would like to learn more about this proposal, or any other of the Administration's tax proposals, please call or e-mail Alan Griffith, Principal in Charge of the Stonefield Josephson Tax Group, at (310) 432-7407, or agriffith@sjaccounting.com, or any other Los Angeles-based principal. (Toll free number: 866-225-4511).



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