

IRC SECTION 1202

Concept Overview & Illustrations

Congress has recently provided for 100% tax-free sales of certain businesses in order to incentivize venture capital investments and entrepreneurship. This tax break is found in IRC 1202 and applies to the sale of corporate stock for owners of C-Corporations where the stock has been held for at least 5 years within certain specific industries. These industries are generally active businesses that are not predominantly real estate or professional services.

Section 1202 allows for 100% elimination of capital gains tax on the sale of Qualified Small Business Stock (QSBS) on the greater of \$10 million or 10 times the adjusted basis for shareholders of C-Corporations who have held their stock for at least 5 years. This can be accomplished immediately if, prior to signing a binding letter of intent to sell an appreciated asset, the owner transfers assets via a tax-free 351 exchange into a pre-existing C-Corp which has been in operation for at least 5 years and the new C-Corp shares are issued to the owner who now has at least 80% ownership of the C-Corp. In this case, the C-Corp's "pre-existing" holding period are "tacked on" to the seller's resulting in the seller avoiding 100% of the capital gains tax on the sale of his/her C-Corp stock. The business purpose requirement of the 351 exchange is met under the established Continuation of Business Enterprise (COBE) requirements.

Businesses that are excluded from this particular transaction include those primarily based on real estate or other professional services i.e. an office building, a medical or legal practice, etc. In addition, several states do not recognize the federal regime of this transaction in which case, state tax associated with the gain may still be recognized by the seller. However, careful planning can often reduce or eliminate the aforementioned state gains tax exposure in many situations.

THE BENEFITS OF THE IRC SECTION 1202 ARE AS FOLLOWS:

- Eliminate federal (and possibly state) gains tax on the sale of your business if it meets the criteria
- Offers complete liquidity from the sale of the stock
- Eliminates any on-going structure or fees
- Gives the seller complete control of the proceeds from the sale of the stock

Contact us to learn more or determine if your business might qualify for this unique strategy and one of our experts will be happy to discuss your particular situation in greater detail.

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