

LEGAL UPDATE

October 2010 By: *Eric B. Woldenberg, Michael P. Dunworth and Martin J. Jones*

EXPANDED TAX EXCLUSION FOR SALE OF QUALIFIED SMALL BUSINESS STOCK ACQUIRED ON OR BEFORE DECEMBER 31, 2010

On September 27, 2010, President Obama signed the Small Business Jobs Act of 2010 (H.R. 5297). One part of this legislation expands the exclusion of income tax available for the sale of qualified small business stock pursuant to Section 1202 of the Internal Revenue Code. Specifically, the legislation excludes from taxable income all of the federal income tax otherwise payable on the sale of qualified small business stock held by a non-corporate taxpayer for more than five (5) years.

In order to qualify for this exclusion of 100 percent of the gain from the sale of qualified small business stock, a taxpayer must acquire the qualified small business stock after September 27, 2010, and no later than December 31, 2010. In contrast, (i) only 75 percent of the gain from the sale of qualified small business stock acquired between February 18, 2009, and September 27, 2010, is excluded from a taxpayer's income, and (ii) only 50 percent of the gain from qualified small business stock acquired after December 31, 2010 will be excluded from taxable income.

The following are the principal requirements for an acquisition of stock to qualify for the 100 percent qualified small business stock tax exclusion under the new legislation:

1. The corporation issuing the stock must be a U.S. C corporation (not an S corporation).
2. The taxpayer must acquire the qualified small business stock by original issue from the corporation in exchange for money, property or services (other than underwriting services) after September 27, 2010, and on or before December 31, 2010.
3. The taxpayer must hold the stock for more than 5 years before selling it.
4. The aggregate gross assets of the corporation issuing the stock must not exceed \$50 million immediately after the stock issuance, and must not have exceeded \$50 million at any time prior to the stock issuance.
5. For substantially all of the period during which the taxpayer holds the stock, at least 80 percent (by value) of the corporation's assets must be used in the active conduct of one or more qualified trades or businesses. For this purpose, a "qualified trade or business" is any trade or business other than one of the following:
 - A trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial sciences, performing arts, consulting, athletics, financial services, brokerage services, or any other trade or business where the principal asset of such trade or business is the reputation or skill of one or more of the employees of the business;
 - Any banking, insurance, financing, leasing, investing or similar business;
 - Any hotel or restaurant business or similar business; or

- Any farming business or business involving the extraction of certain natural resources.

The qualified small business stock exclusion is generally limited to \$10 million per taxpayer with respect to any single corporation. In addition, no alternative minimum tax will be imposed on the sale of qualified small business stock acquired after September 27, 2010, and on or before December 31, 2010. However, a portion of the gain from the sale of any qualified small business stock acquired after December 31, 2010, will be subject to alternative minimum tax.

An individual taxpayer should claim the exclusion from gain on the sale of qualified small business stock by including the sale on Schedule D of his or her Form 1040, and writing "Section 1202 Exclusion" immediately below the line listing the sale. Similar rules apply with respect to the sale of qualified small business stock by partnerships or limited liability companies.

The qualified small business stock exclusion is subject to certain other specialized requirements and exceptions.

The foregoing is merely a discussion regarding the details of the tax exclusion available with respect to the sale of qualified small business stock acquired on or before December 31, 2010. If you would like to learn more about this topic or how Pryor Cashman LLP can serve your legal needs, please contact Eric B. Woldenberg 212-326-0865, Michael P. Dunworth 212-326-0833 or Martin J. Jones 212-326-0145.

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Eric B. Woldenberg joined Pryor Cashman in 1984 and has been a partner since 1988. Eric is the Chairman of the Tax Group and specializes in taxation and estate planning. Eric has extensive experience in negotiating and structuring a broad range of transactions, including mergers and acquisitions of both private and public companies. A significant portion of his practice is devoted to estate and tax planning for high net worth individuals and families. Eric is regularly involved with tax controversy work involving federal and state tax matters.



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Michael Dunworth is a partner in Pryor Cashman's Tax Group with a broad-based transactional practice. Mr. Dunworth advises on federal income tax issues involved in international and domestic project financing, infrastructure investments, mergers and acquisitions, equipment and facility leasing, real estate and partnership transactions, and related tax controversy work. He has represented investors in and sponsors of investment funds, lessors, lenders and lessees in leasing transactions, and investors in real estate, affordable housing, historic rehabilitation, alternative energy and infrastructure transactions.

Mr. Dunworth's recent experience includes representing:

- An Australian investment fund in the acquisition of a \$1.6 billion of electric generating stations
- The fund sponsor on the restructuring of a \$60 million international real estate fund
- A real estate developer in obtaining a private ruling from the IRS on the treatment of payments in lieu of taxes (PILOT)
- A Singapore investment fund on structuring the acquisition of a partnership interest in a \$350 million electric transmission line project
- The fund sponsor in the formation of a \$150 million real estate fund
- Investment banks in developing partnership structures for infrastructure investments
- A foreign real estate fund in the acquisition of a \$56 million multifamily housing development
- The subsidiary of a Japanese bank in connection with the audit of its leasing portfolio
- Parties to like-kind exchange transactions involving commercial real estate
- The Creditors' Committee in the Mirant Corporation bankruptcy
- Lessors and lessees in restructuring their lease obligations

- Equity investors, lenders and lessees in true lease financings of aircraft, rolling stock, equipment and facilities located in Austria, Belgium, Canada, France, Germany, Ireland, Korea, New Zealand, The Netherlands, Singapore and the United States
- Sellers and purchasers of leveraged lease portfolios
- The lenders in a series of structured financings for California power companies
- Investors in U.S. wind energy projects
- Investors and developers in historic rehabilitation projects
- Investors in affordable housing projects

Mr. Dunworth, who served in the United States Marine Corps Reserves, practiced as a certified public accountant during the early 1980's.

He received his LL.M in Taxation from New York University School of Law, his J.D. from Pace University (*cum laude*) and a B.S. in Accounting from Manhattan College.



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Martin Jones is Of Counsel in Pryor Cashman's Tax Group. His experience includes structuring corporate and partnership transactions, and researching the tax consequences thereof, including mergers, acquisitions, liquidations, limited liability company formations, bankruptcy restructurings. Martin's representative transactions include:

- Acquisition of all outstanding stock in several coal mining companies
- Acquisition of New York City development site for the construction of a condominium building
- Bankruptcy reorganization of company and creation of trusts to discharge asbestos-related liabilities
- Cross-border financing of production costs for a motion picture filmed outside the United States
- Formation of venture capital fund specializing in the healthcare industry
- Joint venture for the development of a resort in the Caribbean
- Managed residency audit of New York State personal income taxpayer
- Obtained a settlement of a New York State sales tax case for approximately 20 percent of the original assessment
- Operating agreement for company formed to operate furniture stores
- Structuring tenant in common (TIC) arrangements to facilitate deferred like-kind exchanges of real estate