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Small Business Investment Incentives

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Among the small business incentives in the 2010 Tax Relief Act (the Act) signed into law last week by president Obama is a provision that increases incentives to invest directly in small businesses. Section 760 Act amends section 1202 of the Internal Revenue Code (the Code). The Code now provides for that if an investment is made in 2011 in stock of a qualified small business and the stock is held for five (5) years the gain is tax free. For periods prior to 2011, the Code section 1202 incentive was a fifty percent gain exclusion.

The budget scoring by the Joint Committee on Taxation states the budget effect to be \$40 million years 2011-2015 and \$1,445 Billion between 2011-2020. Note should be taken that the budget effect estimated by the Joint Committee on Taxation includes effects of investments made in 2011 at 100% gain exclusion and at 50% gain exclusion for prior years. These estimates do not consider the offsetting effect on the growth of small business and jobs. The question is whether California should conform the Revenue and Taxation Code to create a similar small business incentive.

Some of the details of the Code section 1202 stimulus are as follows: The investment must be in qualified small business stock. That means the investment new shares of what for tax purposes is a C corporation. To be a qualified small business a company must be a domestic corporation with aggregate gross assets of \$50,000,000 or less both before and after the issuance of the new shares. At least eighty percent of the assets must be used in an active trade or business. An active trade or business means a trade or business other than a personal service business like law, medicine, engineering, consulting, athletics, financial [services](#), and other trades or businesses where the business is dependent on the reputation or skill of 1 or more of its employees.

The investment must be made as an original issue and can be either for money, property or [services](#) performed, other than as an underwriter. These are sensible criteria for California to adopt in creating a business/jobs stimulus package.

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California could benefit from conforming legislation and creating a single investment year opportunity mirroring Code section 1202. The single period could be considered as a stimulus test as there is currently no California conforming section. The stimulus effect could be gauged and a decision then made on continuance or elimination of the gain exclusion in 2012 and beyond.

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