



Section 1202: Qualified Small Business Stock and Trust Planning

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Agenda for Today

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Why Are We Here and Who Can Benefit from Section 1202?

2

How Does Trust Planning Amplify the Section 1202 Benefits?

3

What Are the Practical Takeaways?

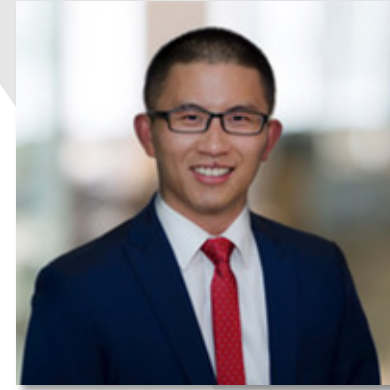
With You Today



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Why Are We Here?

- Under I.R.C. Section 1202, certain shareholders are excluded from paying capital gain taxes on sale of stock.
- The federal tax saving could be as high as 23.8%.
- Many states follow the federal rules.

Who Can Benefit From Section 1202?

- Founders, family members, trusts
- Officers and employees who own stock
- PE and VC
- Other Investors, typically “early” investors

What Type of Investments Are Section 1202 Eligible?

- Stock in C corporations
- Not eligible:
 - Units in partnerships (including many LLCs)
 - Stock in S corporations
- “Qualified” Small Businesses

How Much Gain Can Be Excluded Under Section 1202?

- Each taxpayer is capped at the higher of \$10 million or 10 times the basis of the stock sold.
- Many shareholders owning stock in the same corporation?
- Same shareholder owning stock in multiple corporations?
- Ownership through a PE and VC?

How Can Trusts Be Used in Section 1202 Planning?

- Trusts can be used to create additional taxpayers with their own Section 1202 exclusion
- Must be a non-grantor trust
 - Completed Gift
 - Incomplete Gift (“ING”)

What Are the Commercial Considerations For Trust Planning?

- Voting/control
- Cap table optics
- Valuation

What Is the Ideal Timing for Trust Planning?

- Earlier the better
- Downside is the cost of setting up the trust

What Are the Major Section 1202 Requirements?

Shareholder Requirements

- Non-corporate taxpayer, with additional requirements if owning stock via a partnership
- Acquisition after August 10, 1993
- Original issuance for cash, services, or property other than stock
- Five-year holding period
- Redemption transactions

Corporate-Level Requirements

- Domestic C corporation
- Qualified trade or business
- Active trade or business (i.e. the 80% gross assets test)
- Gross assets less than \$50 million
- Redemption transactions