

IRC Section 1202 Qualified Small Business Stock Checklist



To the preparer of this checklist:

The purpose of this checklist is to assist non-corporate taxpayers in identifying which of their investments in common or preferred stock may qualify as Internal Revenue Code Sec.1202 qualified small business stock (QSBS). The checklist is intended to assist in determining if a corporation meets the definition of qualified small business stock under federal tax law only. For state tax purpose, the extent of a particular state's conformity to the federal tax law will need to be addressed separately.

If all of the requirements are met, 50%, 75% or 100% of the gain on the sale of QSBS may be excluded from income taxation by the taxpayer depending upon the date of acquisition. Although it should be noted that for the 50% and 75% excluded gains, there is also an Alternative Minimum Tax preference addback. In addition, the taxpayer may be able to defer from current taxation all or a portion of the gain on the sale of QSBS pursuant to Code Sec. 1045.

The several items marked *Taxpayer Note* are for the benefit of the ultimate recipients of the checklist.

Questions 1-8 **[Federal Requirements]**

If the answer to any of these questions (1-8) is No, the stock does not meet the federal requirement for qualified small business stock and you need not continue with the checklist.

- | | Yes | No |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|-----|
| 1. Is the issuing corporation a domestic C corporation? <i>[See Note A]</i> | [] | [] |
| 2. Was the stock issued after August 10, 1993 for money, other property (not including stock), or as compensation for services (other than underwriter services)? | | |
| 3. At all times of the corporation's existence after August 10, 1993, and up to the time immediately following the issuance of stock, was the adjusted (tax) basis of the aggregate gross assets of the issuing corporation (or any predecessor) equal to or less than \$50 million? <i>[See Notes B and D]</i> | [] | [] |

[Taxpayer Note: The following active business requirements set forth in questions 4-6 must be met during substantially all of a taxpayer's holding period of Code Sec. 1202 stock.]

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| 4. Since the date of issuance of the stock, has at least 80% (by value) of the assets of the corporation been used in the active conduct of one or more qualified trades or businesses? <i>[See Notes C, D and E]</i> | [] | [] |
| 5. Since the date of issuance of the stock, has 10% or less of the total value of the corporation's assets consisted of real estate not used in the active conduct of its qualified trade or businesses? <i>[See Notes C, D and F]</i> | [] | [] |
| 6. Since the date of issuance of the stock, has the corporation held stock or securities, other than subsidiaries, with a value equal to or less than 10% of its net assets (assets in excess of liabilities)? <i>[See Notes D and G]</i> | [] | [] |

7. Has the corporation not made redemptions during the two year period beginning one year prior to issuance (i) in more than a de minimis amount; and (ii) in an amount in aggregate greater than 5% of the fair market value of all of its stock as of the beginning of such period? [See Notes H and I] [] []
8. Has the corporation not made redemptions of more than a de minimis amount of its own stock from investors in the two years prior to issuance and two years since issuance? [See Notes I and J] [] []

Questions 9-10
[Tax-Free Transaction]

The following questions have no bearing on whether or not the stock is QSBS; answers to these questions are required in order to determine the period of time over which appreciation may be subject to QSBS treatment where the stock has been involved in certain tax-free transactions.

9. Has the corporation been a party to a tax-free transaction under Code Sec. 351 or 368 in which the stock identified the top of page 1 of this checklist (the *Identified Company*) was exchanged for stock in another corporation (the *New Company*)?

Yes [] No []

10. If the answer to the above question is NO, this question is of no further effect.

If the answer to the above question is YES, this checklist must be answered with respect to the stock of the *New Company* that was received in consideration for the stock of the identified company as part of the tax-free transaction.

Does the *New Company* meet the definition of qualified small business stock as outlined in the checklist?

Yes [] No []

Taxpayer Note: If the answer to question 10 regarding the *New Company* is YES, the *New Company* stock may also be QSBS, and the *New Company* stock appreciation generated subsequent to the date of the tax-free transaction may continue to qualify as QSBS for tax purposes.

If the answer to question 10 regarding the *New Company* is NO, only the gain that would have been recognized at the time of the tax-free transaction may qualify as QSBS for tax purposes.

Notes

- A. For the purposes of this question, a domestic C corporation does not include the following:
- A DISC (Domestic International Sales Corporation), or former DISC.
 - A corporation with a Code Sec. 936 election in effect (including direct or indirect subsidiaries) a RIC (Regulated Investment Company), REIT (Real Estate Investment Trust), REMIC (Real Estate Mortgage Investment Company), or cooperative.
- B. The adjusted (tax) basis of the aggregate gross assets also includes the fair market value of assets on the date of issuance if such assets were received in a contribution transaction.
- C. A *qualified trade or business* means any trade or business except the following:
- The performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.
 - Any banking, insurance, financing, leasing, investigating, or similar business.
 - Any farming business (including the business of raising or harvesting trees).
 - Any business involving the production or extraction of products of a character with respect to which a deduction is allowable under Code Sec. 613 or 613A.
 - Any business of operating a hotel, motel, restaurant, or similar business.
- D. For the purposes of the question, a parent corporation shall be deemed to own its ratable share of a subsidiary's assets and to conduct its ratable share of the subsidiary's activities. A corporation shall be considered a subsidiary for these purposes if the parent owns more than 50% in value of all outstanding stock of such corporation.
- E. For the purposes of this question, any assets that are held (i) as part of the reasonably required working capital needs of a qualified trade or business of the corporation, or (ii) are held for investment and are reasonably expected to be used within two years to finance research and experimentation in a qualified trade or business or increases in the working capital needs of a qualified trade or business shall be treated as used in the active conduct of a qualified trade or business. However, after the corporation has been in existence for at least two years, no more than 50% of the corporation's assets can qualify as used in the active conduct or a qualified trade or business by reason of the language or the preceding sentence.

- F. The ownership of, dealing in, or renting of real property is not treated as the active conduct of a qualified trade or business.
- G. Stock or securities does not include working capital or investment in subsidiaries. For this purpose, working capital consists of (i) the reasonably required working capital needs of a qualified trade or business of the corporation, or (ii) assets held for investment which are reasonably expected to be used within two years to finance research and experimentation in a qualified trade or business or increases in the working capital needs of a qualified trade or business. However, after the corporation has been in existence for at least two years, no more than 50% of the corporation's assets can qualify as used in the active conduct of a qualified trade or business by reason of the language of the preceding sentence.
- H. Stock exceeds a de minimis amount only if the aggregate amount paid for the stock exceeds \$10,000 and more than 2% of all outstanding stock purchased.

Any transaction that is entered into by the issuing corporation that is treated as a distribution in redemption of stock under Code Sec. 304(a) within the two-year period beginning one year prior to the issuance shall be treated as a redemption for purposes of question 7. Code Sec. 304(a) treats as a distribution in redemption of stock:

- A subsidiary acquiring a parent corporation's stock from a parent shareholder.
 - A brother-sister corporation acquiring stock of a related corporation from a controlling shareholder.
- I. Certain transfers or purchases of stock are not considered redemptions for purposes of questions 7-8:
- A stock purchase is not considered a redemption if:
 - The stock was acquired by the seller for the performance of services as an employee or director and the stock is purchased from the seller incident to the seller's retirement or other termination of services.
 - The stock is purchased within three years and nine months from the date of the decedent's death from the decedent's estate, beneficiary, heir, surviving joint tenant, or surviving spouse or from a trust established by the decedent or decedent's spouse;
 - The stock is purchased incident to the divorce of the selling shareholder.
 - A transfer of stock by a shareholder to an employee or independent contractor is not treated as purchase of the stock by the issuing corporation even if the stock is treated as having first been transferred to the corporation.
- J. Any transaction entered into the issuing corporation that is treated as a distribution in redemption of stock under Code Sec. 304(a) within the four-year period beginning two years prior to the issuance shall be treated as redemption for purposes of question 8. Code Sec. 304(a) treats as a distribution in redemption (i) a subsidiary acquiring a parent corporation's stock from a parent shareholder, and (ii) a brother-sister corporation acquiring stock of a related corporation from a controlling shareholder.