IRS IRC §1202 enables the Tax-Free sale of a qualified US Business

By Howard Francis, Author of 3 Books

1. **True or False?** Each business owner does not pay any tax on their first $10 million of sales proceeds in a business sale? **True if you use** §1202 it does not matter if it is an asset or a stock sale.
2. **True or False?** Investors and business buyers do not pay any capital gains taxes until their return in a sale or investment exceeds 1,000% (10X) of their original investment? **Also True using §1202.**

- In order for a Buyer or Investor to acquire **§1202 status** the original sale had to be a stock sale & 5 years must pass from the date of that stock purchase to become QSBS eligible.

Example, A private equity firm bought / invested in a company for $20 million, and over the next 6 years the value of their shares increase in that company to $220 million. Using QSBS they would pay NO taxes on a sale. Taxes would only begin to be calculated after the first $220 million of sales proceeds.

Since 1993, Silicon Valley venture capitalists and we private equity firms have used QSBS to increase value for both sellers and buyers. I am the CEO of a private equity firm that is a QSBS go to expert for mid-market M&A firms, CPA and law firms. Fewer than 10% of businesses qualify for QSBS; however, our QSBS expertise increases that 10% to the majority of businesses assuming they have an eligible business activity. The 7 major benefits QSBS provides America and families are explained on page 3 of this article. Our mission is to popularize QSBS on Main Street which is 25 years over due. So please, share this article.

Let us now verify that the 2 True or False bullets above are true using two of the most credible 3rd party sources available - the American Bar Association and Bloomberg Tax.

First, on the American Bar Association website is an August 3rd, 2018 article appropriately entitled "***Section 1202: A Big Deal for Small Business"*** from which the quote below appears on page 2 of that article.

B. "Limitations on Gain Exclusion

The statute limits the per-issuer amount that can be excluded to "eligible gain," which is the greater of:

1) $10 million reduced by any amount the taxpayer excluded from sales or exchanges of QSBS from the same issuer in prior years, or

2) 10 times the aggregate adjusted basis of the QSBS issued by the corporation disposed of by the taxpayer during the taxable year, as measured on the original issue date."

To verify this quote go to our educational website www.ProfitsUSA.com, look under our video on the home page to the left and locate the title ***"American Bar Assn".*** Click on the text *click to go to google* under this ABA title. You will be forwarded to an article on the ABA website. Scroll down to page 2 and in the B part of the section entitled "***Overview of Section 1202"*** you will see the italicized gray colored text above.
If you would like to download a highlighted version of this ABA website article, which takes 75% less time to read than the original, click on the black colored square button under the title ***"American Bar Assn"*** entitled *"Download ABA Article"* on the www.ProfitsUSA.com website.

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The second 3rd party article verifying that the two True or False tax benefits are true is a 12 page "***Bloomberg Tax "***PDF which has 123 footnotes referencing the IRS's tax code. Bloomberg Tax has 1,400 employees and is a subsidiary of Bloomberg L.P owned by the Mike Bloomberg. and is one of the most respected sources of legal, tax, regulatory, and business information for professionals. This article can also easily be downloaded from the homepage of our www.ProfitsUSA.com website. This 12 page primer answers most CPA questions. To download it click on the black colored button entitled "***Download BT article"*** under the title *"Bloomberg Tax"*. The quote below is from the 1st paragraph on the 1st page of this article.

INTRODUCTION

"Section 1202 was enacted in 1993 and generally provides non-corporate taxpayers with an exemption from federal income tax for eligible gains from the sale of qualified small business stock in subchapter C corporations held for more than five years. As described in more detail below:

- *The 1202 exemption generally is limited to the greater of $10 million per taxpayer, or*
- *10 times the taxpayer's original adjusted tax basis in the 1202 stock."*

Example of How QSBS Nets a Seller 51% More on a $10 million California Business Sale

Scenario #1 the Status Quo. Seller nets $6.3 million after paying 37.1% in 3 different Taxes.

1. **T**axes are 1.) 20% Federal long term Capital Gain taxes + 2.) 13.3% California state Capital Gains taxes + 3.) 3.8% NIIT (federal Obamacare) and total is 37.1 % in taxes.

2. The tax amounts are: ($2 million Fed Cap Gains +$1.33 million CA Cap Gains + $380,000 NIIT)
   - Net client amount is $6.3 Million since $10 million - $3.71 million in 3 taxes = $6.3 million.

Scenario #2 using QSBS there are ZERO taxes 51% MORE on the same $10 million sale

- Seller Nets $9.5 Million instead of $6.3 million - 51% more (after fee) since no taxes are paid.

A QSBS §1202 business sale also does not negatively effect liquidity, nor does it entail using a charity, nor any ongoing structure, nor does it require any type of reinvestment of the sales proceeds.

Scenario #3 Buyer pays 20% Less Yet Seller Nets 20% More than Status Quo. Why ? QSBS

3. Buyer pays $ 8 million instead of $10 million - 20% less.
4. yet… Seller Nets $7.6 million instead of $6.3 million - 20% more.

The 6 Major Benefits QSBS Provides American Families

1. Have a 401k or mutual fund? There are companies in it which owe their success to venture capitalists.
   - America's venture capitalists and angel investors are the envy of the world for creating wealth by discovering new innovative business ideas. They fund these embryonic businesses and build companies around these innovators. If they go public, your 401k and mutual funds may benefit.

2. When someone aged 50 to 70 sells their business they generally retire. The influx of additional millions of dollars from a sale using QSBS often benefits their extended family and friends. This manifests itself in new mortgages for home buyers, education, vehicles, daycare. There are Many additional benefits.
3. The extended family improves its quality of life since the business seller can pay for daycare, have more frequent and better family get togethers, offer better healthcare and dental etc. to family members.
4. Too often male business owners have not done the appropriate estate planning or the asset and creditor protection their family requires for generational security. Generally, it is a combination of these 5 factors:
    - #1.) business cash flow is too tight or problematic.
    - #2.) the uncertainty of their cash reserves arising from the fact that business owners have to personally cover any business cash flow requirements. Many business owners spent "their retirement funds" on growing their business. Their retirement assets, business value aside, are inadequate.
    - #3.) they lacked the time or peace of mind required to, plan as a result of business stress.
    - #4.) Most of their wealth is tied up in their business and they lack the life insurance death benefit their surviving spouse and family requires for estate planning and other purposes.
    - #5.) Most California families lack the asset & creditor protection required for a stress-free retirement.
        1. In California, according to *CA Civil Procedural Code. §704.730* , $75,000 of the equity in a home is exempt from creditors if you are married and if you are married and a senior it is $150,000.
        2. According to *CA Civil Procedural Code.* §704.100 only $9,700 of the cash values in a life insurance policy are protected from creditors if you are single and $19,400 if you are married
        3. Whereas, in Florida 100% of both the equity in a home (Fla. Const. Art. X, §4, Fla. Stat. Ann. §§222.01 & 222.02) and the cash values in a life insurance policy (Fla. Stat. Ann. § 222.14) are fully protected from creditors. Texas offers the same creditor protection.

    We can optionally provide both estate planning and asset/creditor protection for a seller if the Seller requests it. This creates additional M&A advisor value. We can provide a free 2nd opinion on a Seller's existing estate planning and asset/creditor protection and this provides additional client peace of mind.
5. Angel investors invest both their time and money into small business and get involved before venture capitalists. The wealth of and great number of angel investors is indispensable to the success of the US economy. Angel investors are usually the first smart money and experienced business professionals to get involved with silicon valley like technology start ups. QSBS allows a greater number of successful business owners to become angel investors since more businesses are sold and the seller nets more money than they otherwise could as a result of paying less taxes. Increasing the number of angel investors is great for America's long term economic vitality, competitiveness and success.
6. In contrast to entrepreneurial America, in Europe they have a less business friendly approach. In Europe most financing for business is provided by banks and then government. In America it is wisely private money. Who would you bet on to help grow a winning small business or start up? A seasoned, successful business owner with skin in the game and decades of relevant expertise, or a banker?

Following is a detailed, professional explanation of :

1. Which 24 business activities DO NOT qualify for QSBS, (there is no work around)
2. What the qualifications for QSBS are,

Listed below are 24 business activities which DO NOT Qualify for QSBS. Any combination of these 24 business activities may not exceed 20% of your total business activity in order for your business to become

QSBS eligible. There is no attorney work around for ineligible business activities exceeding 20% of your total business activity. However, we can provide alternative tax strategies to QSBS if you do not qualify.

The 24 business activities which are ineligible for QSBS are:

- health, law, engineering, architecture, accounting, actuarial science, performing arts,
- consulting, athletics, financial services, brokerage services,
- or any other trade or business where the principal asset of the trade or business is the reputation or skill of one or more of its employees.
- banking, insurance, leasing, financing, investing, 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 for which percentage depletion is allowable under section 613 or section 613A (i.e., oil or gas properties subject to depletion); or any business of operating a hotel, motel, restaurant, or similar business.

Additionally, the business must be an "eligible corporation," and such also excludes:

- a DISC (a domestic international sales **corporation**),
- a corporation that either has a §936 election in effect or one of its subsidiaries does,
- a regulated investment company, REIT, or REMIC, or
- a cooperative.

Alabama, California, Mississippi, Pennsylvania and Wisconsin do not follow federal QSBS guidelines and our attorneys make that irrelevant as well.

The conclusion of the reader should be having a CPA tax professional aware of Section 1202 is a plus.