**8591. What are the requirements to exclude 50 percent of the gain on the sale of qualified small business stock?**

If certain requirements are met, a noncorporate taxpayer (including certain partnerships and S corporations) may exclude from gross income 50 percent of any gain from the sale or exchange of qualified small business stock held for more than five years.[[1]](#footnote-1) With certain exceptions, a qualifying small business is:

* A C Corporation (excludes an S Corporation)
* Any trade or business other than one involving the performance of legal, health, engineering, architecture, account, actuarial services, etc. or any other trade or business in which the principal asset is the skill or reputation of its employees
* At least 80% of its assets by value must be used in the active conduct of a qualified trade or business

The aggregate amount of eligible gain from the disposition of qualified small business stock issued by one corporation that may be taken into account in a tax year may not exceed the greater of the following amounts:

(a) $10,000,000 ($5,000,000 in the case of married taxpayers filing separately) reduced by the aggregate amount of such gain taken into account in prior years; *or*

(b) 10 times the aggregate bases of qualified stock of the issuer disposed of during the tax year.

For purposes of the limitation in (b), the adjusted basis of any qualified stock will not include any additions to basis occurring after the stock was issued.[[2]](#footnote-2)

Gain realized by a partner, shareholder, or other participant that is attributable to a disposition of qualified small business stock held by a pass-through entity (i.e., a partnership, S corporation, regulated investment company, or common trust fund) is eligible for the exclusion if the entity held the stock for more than five years, and if the taxpayer held an interest in the pass-through entity at the time of acquisition and at all times since the acquisition of the stock.[[3]](#footnote-3)

Significantly, a taxpayer is not entitled to the section 1202 50% exclusion as well as the reduced capital gains rates (15% and 20%). Instead, the tax rate is subject to a maximum rate of 28%. Coupled with the 50% exclusion, the actual maximum effective rate on the gain is 14%.

Any gain excluded under IRC Section 1202 by a married couple filing jointly must be allocated equally between the spouses for purposes of claiming the exclusion in subsequent tax years.[[4]](#footnote-4)

Special rules apply to IRC Section 1202 stock for alternative minimum tax purposes (see Q 8537 to Q 8540 for a discussion of the AMT). An amount equal to 7 percent of the amount excluded from gross income for the taxable year under IRC Section 1202 will be treated as a preference item.[[5]](#footnote-5)

1. . IRC Sec. 1202, as amended by ARRA 2009. See also IRC Sec. 1(h)(7). [↑](#footnote-ref-1)
2. . IRC Sec. 1202(b). [↑](#footnote-ref-2)
3. . IRC Sec. 1202(g). [↑](#footnote-ref-3)
4. . IRC Sec. 1202(b)(3)(B). [↑](#footnote-ref-4)
5. . IRC Sec. 57(a)(7). [↑](#footnote-ref-5)