



# QSBS Planning for Shareholders: Trusts, Stacking, Rollovers, and More

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# The Panel



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# **BRIEF QSBS OVERVIEW**

And trust income taxation, as a bonus

# QSBS and Its Benefits

- §1202: Stock qualifying as QSBS will, after a five-year holding period (as specially determined), have part or all of its gain excluded from tax
  - Up to 100% of gain eligible for QSBS issued beginning partway through 2010
  - Built-in stock gain on issuance (due to §351) *ineligible* for exclusion (§1202(i))
  - Exclusion per issuing company limited to greater of \$10M per taxpayer or 10x sold stock basis (as specially determined)
- §1045: Stock qualifying as QSBS will, after a six-month holding period (as specially determined), be eligible to have its gain rolled over to other QSBS purchased within 60 days of sale
- Each benefit applies only to gain taxable to individuals, trusts, estates

# QSBS Requirement Summary

## Manner of Holding Req's.

- Must have been acquired at *original issuance* with three specific exceptions:
  - Certain corporate nonrecognition transactions
  - Certain partnership distributions
  - Gift or at-death transfer
- Special rules for passthrough-held QSBS
- No disqualifying redemptions

## Company Req's.

- C corporation issuer as determined at, after issuance
- Must be a *qualified small business* (C corp with <\$50M of assets since incorporation, as specially measured)
- Must meet *active business requirement* (substantially all assets used in QTB)

# Income Taxation of Trusts in a Nutshell

- Three regimes for understanding income taxation of trusts—trusts can be taxed partly under each regime, and **can toggle between them**
  - Nongrantor trusts: Trust treated as separate taxpayer for income tax purposes; taxed like individual with more compressed brackets and certain other differences (especially that **distributions shift income to beneficiaries under special rules discussed later**)
  - Grantor trusts: Disregarded as separate from grantor for income tax purposes (like DRE)
  - Beneficiary-deemed-owned trust (BDOT): Disregarded from beneficiary for income tax purposes (like beneficiary-owned DRE)
    - Technically a grantor trust subvariety, but kept distinct herein due to unique features

Which regime applies depends on whether certain persons have certain powers over trusts. See IRC §§671-679.

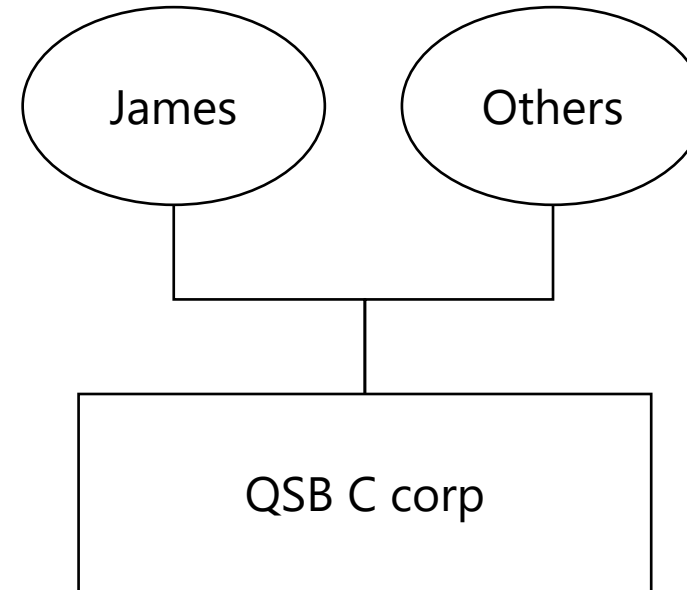
# **CASE STUDIES TO DEMONSTRATE SHAREHOLDER-LEVEL PLANNING**

## Case Study: Stacking

James, a married founder of accompany, has QSBS he held for >5 years, and an exit is on the horizon.

It is estimated to be worth \$50M, with no basis, and was received solely in exchange for services.

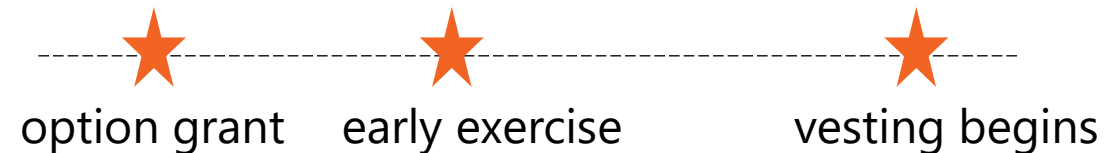
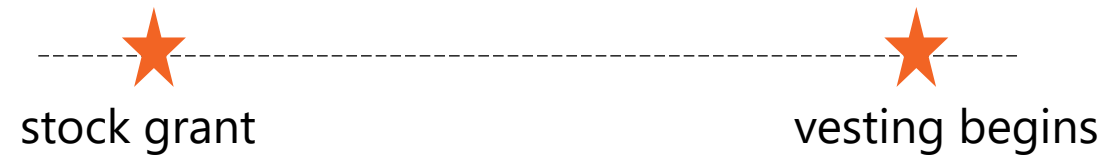
- *What can James do to extend his QSBS exclusion?*
- *What if the sale is imminent?*
- *What if James doesn't want to make a taxable gift for gift tax purposes?*



## Case Study: Equity Incentives

Lucy is a founder granted restricted stock subject to vesting. Lillian is an employee granted stock options subject to vesting with an early exercise feature. The company is a QSB.

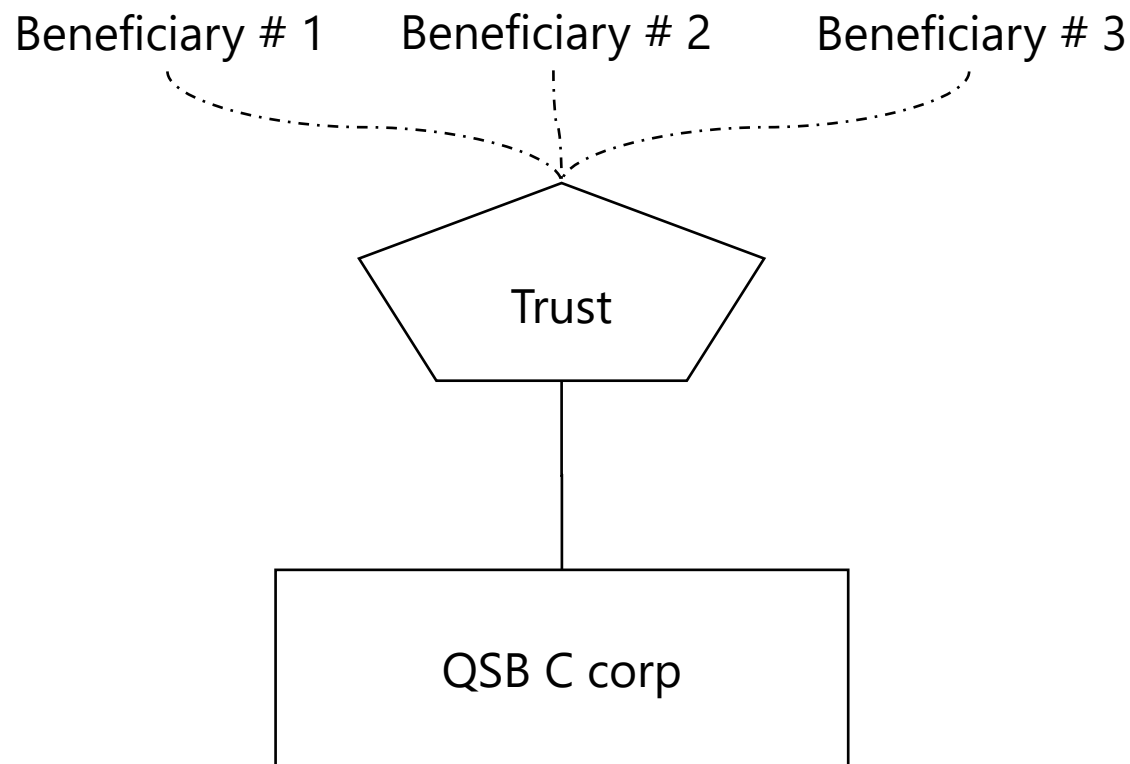
- *When will Lucy's holding period begin for QSBS purposes?*
- *Is it possible for Lillian's holding period to begin for QSBS purposes when she early exercises?*
- *What if the company exceeds the \$50 million test over Lillian's vesting schedule?*



## Case Study: Overfunded Trust

James's nongrantor trust owns QSBS with \$30M of value and \$30M of excludable QSBS gain (with \$0 basis). Accordingly, it can only exclude \$10M of QSBS gain.

- *What can the trust do to extend the gain exclusion if the sale is in the future?*
- *What if the trust already sold the QSBS?*
- *What if the sale from the trust is imminent?*



## Case Study: Packing

Lyla founded her company in 2015 and holds QSBS now worth \$30M. She was granted stock options to purchase an additional \$4M in stock at an exercise price of \$1M (\$3M of ordinary income on exercise). The corporation meets the company-level requirements and there is an acquisition via a tender offer with a buyer.

- *How can Lyla increase her exclusion limitation with the option exercise?*
- *What will be tax consequences to Lyla as a result?*

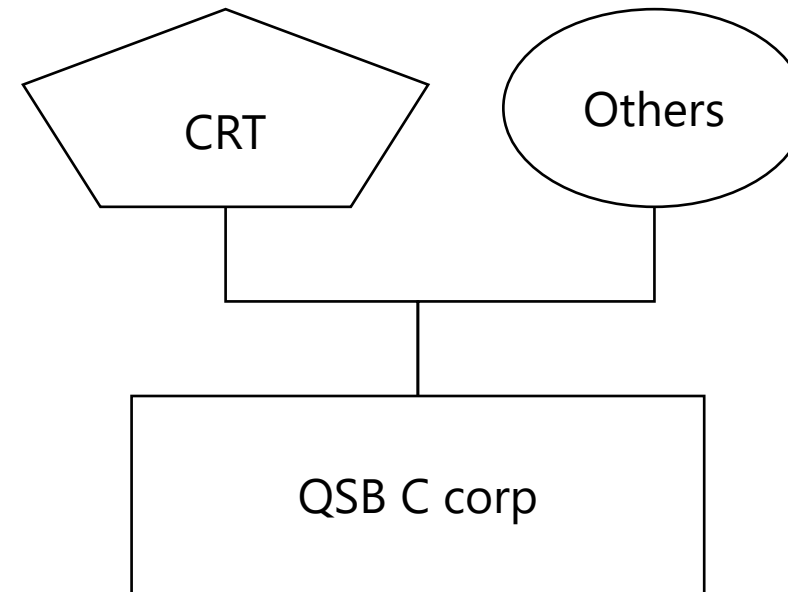
QSBS Shares held over 5 years	Unexercised Stock Options for QSBS
Current Value: \$30,000,000	Current Value (for stock): \$4,000,000
Cost Basis: \$100	Cost Basis (on exercise): \$1,000,000
Spread: \$29,999,900	Spread: \$3,000,000

# Case Study: Charitable Remainder Trust (CRT)

James establishes a charitable remainder trust and transfers to it \$10M of QSBS with \$10M of excludable gain (and \$0 basis).

It later sells the QSBS (after the five-year holding period has been reached).

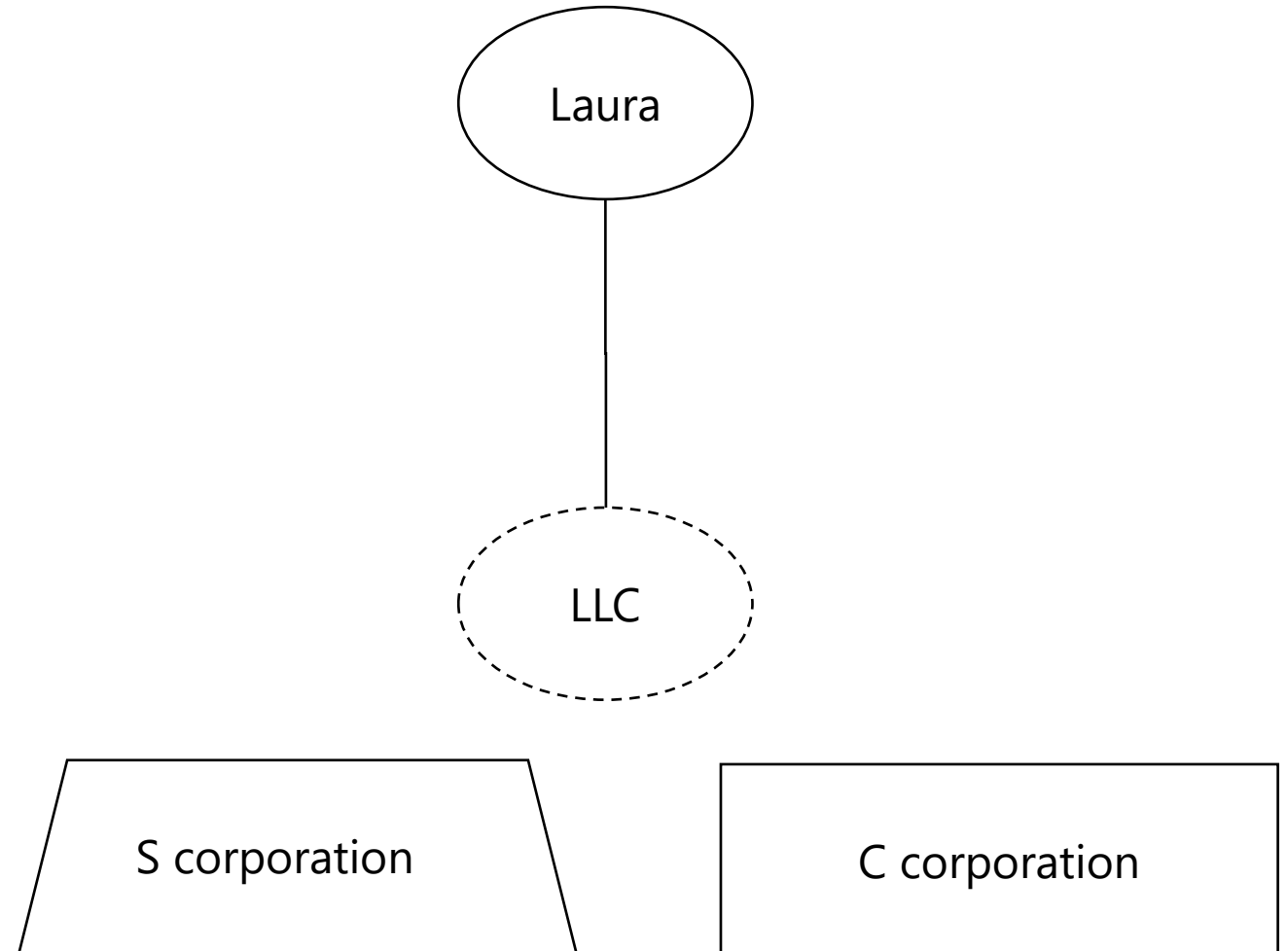
- *Do CRTs get their own \$10M exclusion?*
- *What is the treatment of the QSBS in the tier system?*
- *What happens when the QSBS gain is distributed to a unitrust interest holder?*



## Case Study: Conversion

Laura is the sole member of an LLC for her business, which is disregarded for tax purposes. Her accountant told her she should file an S election to save tax. She believes she will be able to attract investors and wants to know her options for converting to a C corporation for QSBS benefits.

- *What taxes would Laura be saving with the S election?*
- *What would be the potential advantages to staying a disregarded entity for now?*
- *How could she make the S election and then subsequently qualify for QSBS benefits?*

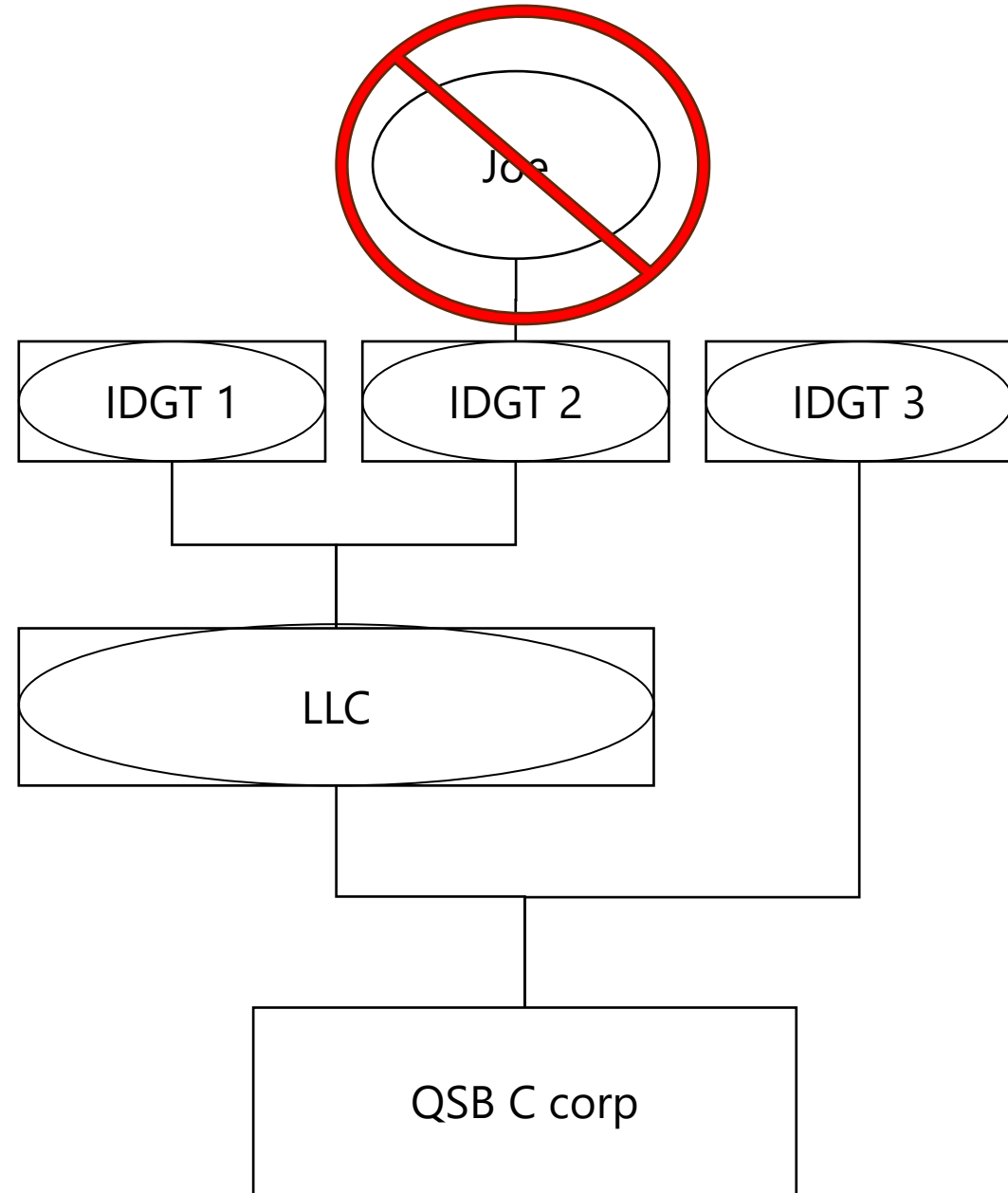


## Case Study: Two to Three Tragedies

Joe owns QSBS, in turn owned by a disregarded LLC owned by multiple IDGTs of his. Another IDGT of his owns QSBS directly.

Joe dies unexpectedly.

- *What basis do the springing trusts have in the QSBS?*
- *How much of the QSBS held in the IDGTs is still eligible for the exclusion?*



## Case Study: Installment Sale

Lynnette sold QSBS held over five years with \$500k basis in a stock sale for \$20M. There is \$10M paid at closing in year 1 and \$10M paid in year 2. She is reporting under the installment sale method under Section 453.

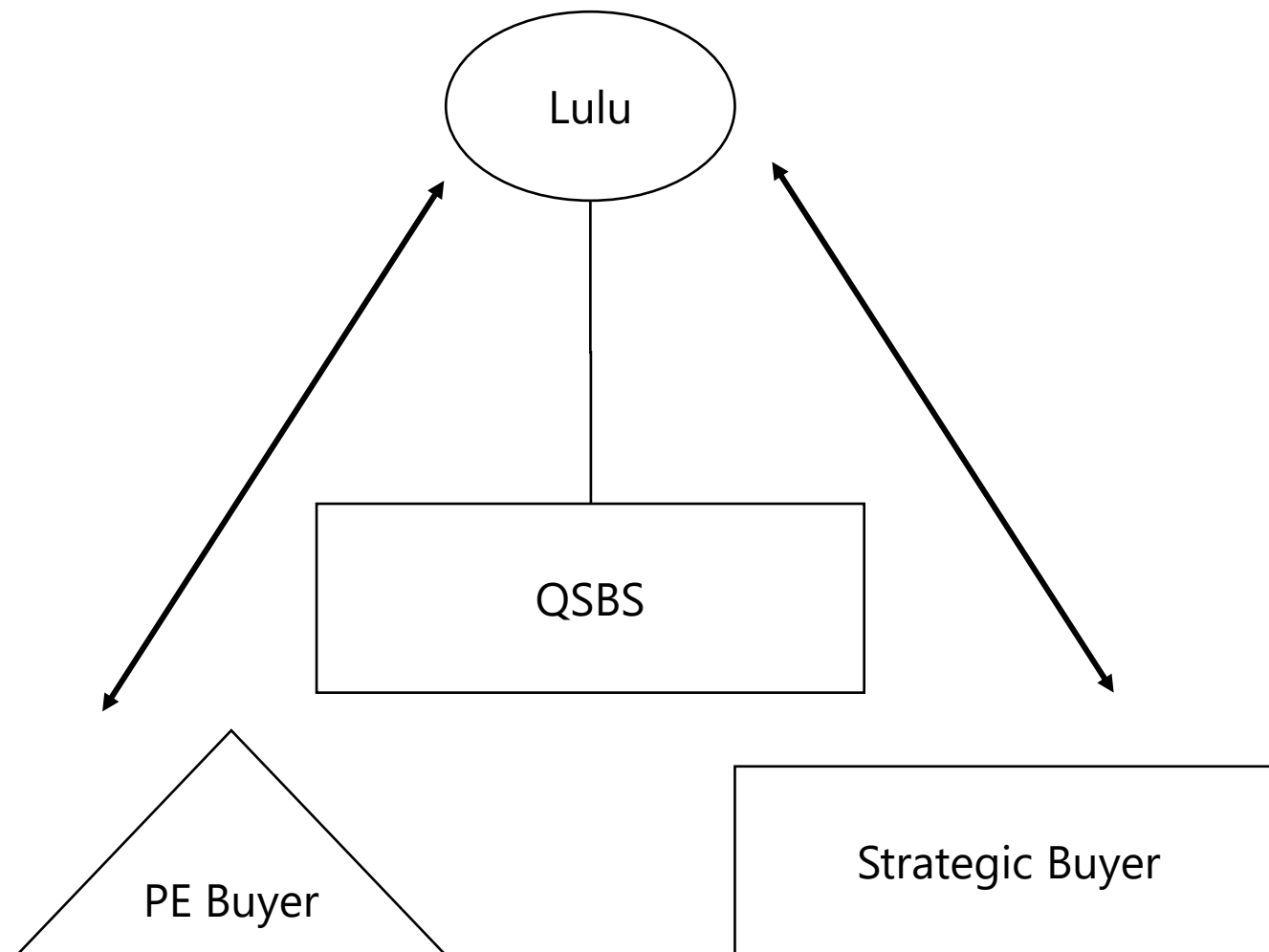
- *What are the two potential approaches on how Lynnette could exclude QSBS gain under the installment sale method?*
- *What is her gain exclusion in year 1 and year 2 under each approach?*

Year 1	Year 2
\$250k allocable basis	\$250k allocable basis
\$10M allocable profit	\$10M allocable profit
\$9.75M gain reported (absent exclusion under IRC section 1202)	\$9.75M gain reported (absent exclusion under IRC section 1202)

## Case Study: Type of Acquirer

Lulu holds QSBS as a founder and is going to market for potential acquisition. She is in early talks with a private equity buyer and a public company strategic buyer. In either case, buyer equity is going to be part of deal consideration for Lulu's shares.

- *What's the difference between PE rollover management equity and public stock from a QSBS perspective?*
- *Is there a way to preserve QSBS exclusion on the PE rollover equity?*

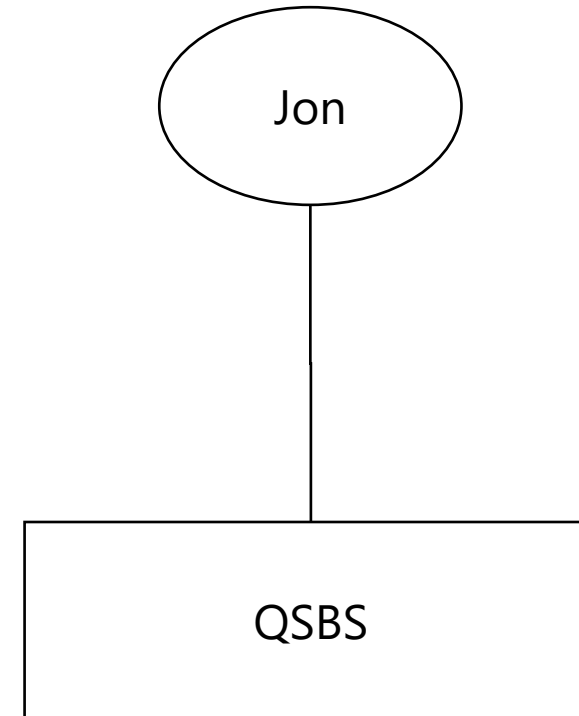


# Case Study: Getting to Five Years with a §1045 Rollover

Jon has owned his QSBS for less than five years and needs to monetize his stock before getting to five years.

Joe has, however, owned his QSBS for at least six months and is interested in using a §1045 rollover. He has stock options and convertible debt in other QSBS issuing corporations, may invest into a VC fund, and might start his own company. He could try to space out his sale proceeds.

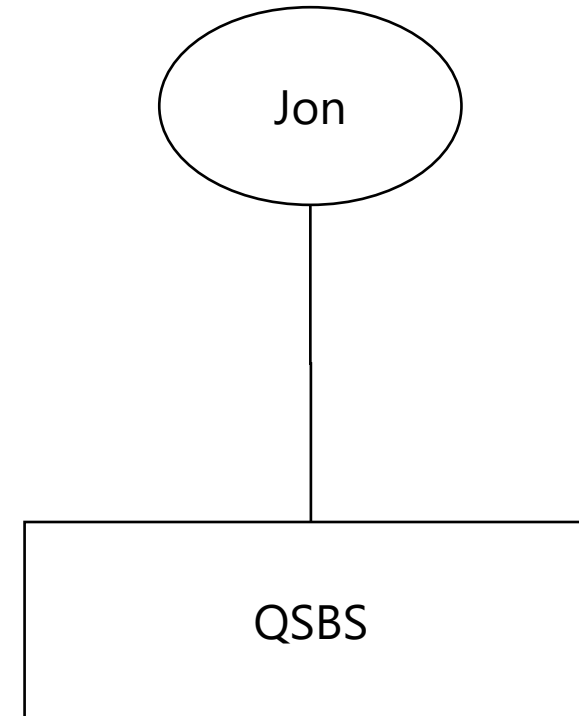
- *Could a §1045 rollover work for Jon's various reinvestments?*
- *Can we extend the timeline for rolling over by spacing out Jon's receipt of sales proceeds?*



## Case Study: Getting to Five Years Through Structuring

Jon has owned his QSBS for less than five years and needs to monetize his stock before getting to five years, and he does not want to use §1045.

- *Could we recapitalize into preferred stock to later liquidate?*
- *What other ways exist to get money now but complete the sale later?*
- *What if Jon is one of many shareholders owning their QSBS through an S corp?*





# Answers to Case Studies

# **CASE STUDY: STACKING**

# *What can James do to extend his QSBS exclusion?*

- Use gifts! These maintain QSBS eligibility (§1202(h)(2)(A)) and each taxpayer has their own \$10M limit per issuers
- Does James's spouse get own \$10M separate from James?
  - Arguably—spouse is in fact a separate taxpayer. *Compare* TAM 9853002 (§453A)
  - But each cut to \$5M if James and spouse file separately. §1202(b)(3)(A)
  - Less favorably, compare *Voss*, 796 F.3d 1051 (9th Cir. 2015)
    - » That case concludes joint filers and separate filers get same total §163(h) interest limit to ensure both couples are treated as "single taxpayer[s]" despite §163(h) only addressing separate filers
    - » The case seems confused and thinks joint filers *are* a single taxpayer
- Nongrantor trusts are ideal donees: Allow for other estate planning goals, state and local tax planning, and can create multiple
  - But watch out for §643(f) if you try to make too many trusts
  - If §643(f) not triggered, multiple trust treatment respected if trusts are not shams and are separately administered
    - » *Estelle Morris Trusts*, 51 T.C. 20 (1968), *aff'd per curiam* 9<sup>th</sup> Cir. 1970; *Stephenson Tr.*, 81 T.C. 283 (1983); *Boyce*, 296 F.2d 731 (5<sup>th</sup> Cir. 1961); *Sence*, 394 F.2d 842 (Ct. Cl. 1968)
    - » For sham trusts, *see, e.g., Sparkman*, 509 F.3d 1149 (9<sup>th</sup> Cir 2007) (*Markosian* factors)

# *What if the sale is imminent?*

- Tax planner must consider anticipatory assignment of income
- If sale is virtually certain to occur at time of gift, then donor (James) will remain taxable on the sale, and the additional exclusion sought will not apply
- Question is based on facts and circumstances; no bright-line test applies here (unlike for certain charitable contribution/redemption transactions)

# *What if James doesn't want to make a taxable gift for gift tax purposes?*

- Best approach would be to do an early, favorably-valued gift
  - GRATs, annual exclusion gifts (if very early in the process) . . .
- See earlier for discussion on spouses having separate exclusions
- Other special trust designs *may* work
  - QTIP SLANT, where QSBS transferred to QTIP for spouse and principal portion of trust only distributable to spouse by adverse parties
  - ING trust
    - Transfers to such trusts *do* appear likely to be gifts
      - » See *Newman*, 4 T.C. 226 (1944), PLR 9109027 (citing *Post*, 26 T.C. 1055 (1956))
    - This will not work to avoid state income taxes in California—see RTC §17082
    - IRS no longer provides rulings that normal ING trusts work federally, so they appear risky; there may be non-standard designs that still work

# **CASE STUDY: EQUITY INCENTIVES**

# *When will Lucy's holding period begin for QSBS purposes?*

- It depends. Did Lucy timely file her 83(b) election to accelerate the income event on the grant?
  - If YES, filing a Section 83(b) election starts the clock on the five-year holding period required under IRC Section 1202. Treasury Regulation § 1.83-4(a).
  - If NO (!!!!), the holding period would start only as the stock vests (and must be included in income).

# ***Is it possible for Lillian's holding period to begin for QSBS purposes when she early exercises?***

- It depends. Was Lillian granted ISO's or NSO's?
  - If ISO's, then apparently not, even with an 83(b) election. IRC section 83(e)(1) specifies that it is inapplicable to any transaction under IRC section 421 (i.e. for ISO's). *See also* IRS INFO 2001-0224 released 9/28/2001. The holding period would begin at the time of vesting.
  - If NSO's, yes, if there is a timely filed 83(b) election.

## ***What if the company exceeds the \$50 million test over Lillian's vesting schedule?***

- If she early exercised NSO's and filed the 83(b) election, there is no material impact on QSBS status with respect to the subsequent vesting dates.
- However, if she early exercised ISO's, no QSBS status for vesting dates once threshold is exceeded.
  - Therefore, only a portion of the stock issued may ultimately qualify.
  - If QSBS status is , consider availability of rescission doctrine if still in the same tax year of grant or whether the annual \$100,000 threshold for ISO grants was exceeded.

# **CASE STUDY: OVERFUNDED TRUST**

# *What can the trust do to extend the gain exclusion if the sale is in the future?*

- Simply distributing the stock to beneficiaries with additional QSBS exclusion limitation appears to work
  - “Gift” appears to have its income tax meaning, and by comparison to Regs. §§1.1245-4(a)-(b) and 1.1250-3(a)-(b) (which take into account “uniform basis” rules for trusts), to include trust distributions
  - Assumes beneficiaries did not purchase their beneficial interest
- If grantor has exclusion limitation, partial or total grantor trust conversion appears to work to move stock to grantor for income tax purposes
  - Either under same reasoning as gift, or under “no transfer” theory of PLR 201730118 and CCA 200923024

# *What if the trust already sold the QSBS?*

- Can retroactively make trust a grantor trust using §675(3)-triggering loan
  - See Rev. Rul. 86-82 for retroactivity
  - Be careful—the portion of a trust made grantor by §675(3) not always predictable, and partial grantor trust status can be a problem if QSBS held in single-member LLC
- If we are in same year and we can push QSBS gain into DNI and distribute it, then it appears beneficiary can get own exclusion (although this is controversial)
  - See reasoning on next slides
  - To get QSBS capital gain into DNI, see Reg §1.643(a)-3(b)
  - Note regs state that §663(b)'s 65-day rule only applies to fiduciary accounting income

# *Argument that we can pass out QSBS gain as DNI to extend exclusion*

- When QSBS enacted, special provisions were simultaneously enacted addressing how QSBS gain is distributed via the DNI and §642(c) mechanisms—see §643(a)(3) and §642(c)(4)
- These rules are modeled on repealed trust rules that concerned old §1202, which gave LTCG a 50% deduction instead of a favorable tax rate
- Those old rules *did* ensure that beneficial tax treatment was “passed through” via distributions (and not stuck at the trust level, severed from passed-through gain)
- DNI income passed out to beneficiaries is taxed by reference to them as income earner, not trust, so they appear to have own exclusion
  - See Regs. §1.652(b)-1 and §1.662(b)-1

# *Addressing counterarguments to DNI position*

- *Counter:* DNI must be computed without QSBS exclusion, so QSBS exclusion does not pass through
  - Response: DNI calculation does not fix character—exempt interest also included in DNI without exemption, but beneficiaries still get the benefit
- *Counter:* Only transfers of QSBS by gift/death keep qualification, and this is not a transfer of stock at all
  - Response: We only need a gift/death transfer if we're transferring QSBS, and here we are not transferring QSBS, so rule has no relevance
- *Counter:* We have specific §1202(g) rules for passthroughs, and T&E not included, therefore they cannot do pass-through of QSBS
  - Response: But we do have special DNI rule in §643(a)(5), showing intent for pass-through to occur here—also §1202(g) is really a *limitation*, not an *enabler*, of pass-through of QSBS

# *What if the sale from the trust is imminent?*

- Technically anticipatory assignment of income rules still matter
- But if the DNI rules work as argued earlier, then with some planning, can ensure QSBS gain would enter DNI even if the trust is the one doing the sale

# **CASE STUDY: PACKING**

# *How can Lyla increase her exclusion limitation with the option exercise?*

- By packing the 10x basis limitation with non-eligible gain
  - It is possible to maximize the 10x basis limitation by selling QSBS held more than five years (i.e. eligible gain) in the same tax year as QSBS held less than five years (i.e. ineligible gain).
  - Section 1202(b)(1)(B): “10 times the aggregate adjusted bases of qualified small business stock issued by such corporation and disposed of by the taxpayer during the taxable year”
  - This is not limited to the bases of only QSBS held over five years. Therefore, a taxpayer can increase the 10x basis limitation by selling QSBS with a high tax basis that does not satisfy the holding period with very low tax basis QSBS that does satisfy the holding period.
- If Lyla sells her shares and unexercised options, she would be subject to a \$10 million per taxpayer limitation, with no QSBS treatment on the options.
- If Lyla instead exercises the options before the sale and then immediately sells the newly acquired stock (along with the original stock), she can use 10x the basis on ALL the QSBS stock sold in that year.

# *What will be tax consequences to Lyla as a result?*

- She exercises the options for \$1M and immediately sells those shares at \$4M, plus her existing shares at \$30M.
- Basis in ALL the QSBS sold in the tax year is ~\$4M, so for the 10x basis limitation, Lyla can exclude as much as \$40M in eligible gain.
- Therefore, all \$30M of her eligible gain is excluded at a cost of the tax due on the \$3M of ordinary income triggered.

# **CASE STUDY: CHARITABLE REMAINDER TRUST (CRT)**

# *Do CRTs get their own \$10M exclusion?*

- CRT is its own taxpayer, so the answer seems to be yes
- Presumably, if CRTs somehow acquired QSBS at original issuance by debt, they could use the QSBS exclusion on gain recognized after five years to avoid UDFI and 100% tax

# *What is the treatment of the QSBS in the tier system?*

- According to the IRS Instructions to Form 5227, all potentially excludable QSBS gain seems to enter the 28% LTCG subtier, with the nonexcludable gain going to the normal LTCG subtier
  - This is consistent with how QSBS gain is taxed for QSBS with only a 50% or 75% exclusion instead of the modern 100% exclusion
- If that's correct, then it comes out ahead of other LTCG (except for gain from collectibles) in the CRT tiers (on the normal worst-in, first-out approach)
- But others debate if this is right: Perhaps excludable QSBS gain should be 0% LTCG or exempt income and distributed last

# *What happens when the QSBS gain is distributed to a unitrust interest holder?*

- This is the most crucial and unclear question
- Some argument that the §1202 exclusion is applied per taxpayer, so you could argue amounts excluded at CRT come out tax-free
  - Would be a shockingly good result
- However, many arguments indicate that CRT should not extend exclusion—it just defers the QSBS gain, which is later taxed to distributee as if distributee earned QSBS directly
  - So if the beneficiary has no \$10M exclusion and there's insufficient basis associated with the CRT's distributed gain, presumably it is wholly taxable at normal LTCG rates
    - » Query how the basis associated with the QSBS in the CRT is accounted for
  - Similar rules apply to CRTs for FTCs (PLR 9313018), §199A, old §1202

# **CASE STUDY: CONVERSION**

# *What taxes would Laura be saving with the S election?*

- Possibly self-employment taxes
  - Assuming she is an owner-operator in a profitable business, the accountant may have in mind the tax savings on distributions from an S corporation, which would not be subject to payroll taxes.
  - “Reasonable compensation” must be paid by the S corporation in exchange for services, still taxable as wages.
- Possibly state income taxes
  - Assuming a high state tax, the accountant may have in mind the S corporation’s ability to make the pass-through entity election to deduct state income taxes, which is not possible as a disregarded entity.

# *What would be the potential advantages to staying a disregarded entity for now?*

- Depending on nature of the business, trajectory, investors, it may be best to allow for further development as a disregarded entity and make the switch to a C corporation upon outside investment.
  - S corporation limitations on investors
    - only individuals, certain trusts, and estates; no partnerships, corporations, or non-resident alien shareholders
  - S corporation limitations on equity
    - Only one class of stock; cannot issue SAFE's; K-1 reporting for owners
- If capital funding becomes available, the pre-money value for the enterprise supports valuation for purposes of 10x basis position. For example, with a pre-money value of \$5 million, Laura would be entitled to a potential gain exclusion of up to \$50 million.
- However, any built-in gain attributable prior to the conversion from a disregarded entity to a C corporation (i.e. \$5 million) would not be subject to exclusion. The conversion must also take place before aggregate gross assets exceed \$50 million.

# ***How could she make the S election and then subsequently qualify for QSBS benefits?***

- Laura's issue would be meeting the original issuance requirement after filing the S election.
  - *See, e.g., Leto v. United States*, No. CV-20-02180-PHX-DWL (D. Ariz. 2022). Taxpayer denied QSBS status after receiving C corporation stock from the exchange of membership interests in an LLC taxed as an S corporation, as an ineligible stock-for-stock exchange.
- Option 1: Contribution of assets under Section 351
  - Formation of a wholly-owned subsidiary C corporation in an assets for stock exchange in a tax-deferred section 351 transaction
  - Pros: Straightforward approach to create two-tiered structure
  - Cons: Lack of continuity for legal entity; new EIN and registrations; assignment of assets

# *(cont'd) How could she make the S election and then subsequently qualify for QSBS benefits?*

- Option 2: F reorganization under IRC section 368
  - Multi-step restructuring:
    - New holding company is formed with stock issued to the LLC members in exchange for all the LLC's membership interests.
    - New holding company files an election with the IRS to treat the LLC as a qualified subchapter S-subsubsidiary (Q-sub) effective as of the transfer, then inherits its S corporation status
    - New C-corporation is formed with the contribution of all the membership interests in the LLC from the new holding company in exchange for stock.
    - New holding company contributes all the membership interests from the LLC into the new C-corporation in exchange for stock, treated as a contribution of assets for stock.
  - Pros: Maintains legal continuity; no need to move assets or employees to a new entity
  - Cons: Three-tiered final structure and complexity in steps



**CASE STUDY:  
TWO TO THREE TRAGEDIES**

# *What basis do the springing trusts have in the QSBS?*

- Under Rev. Rul. 2023-2, clear §1014 not applicable to the IDGTs because they are outside grantor's estate
  - Despite some controversy, Rev. Rul. 2023-2 seems clearly right
- Most commentators agree that a carryover basis rule applies—but which one?
  - §1015(a)—the gift basis rule—seems to make the most sense
  - But §1015(b)—for transfers in trust that are neither gifts nor bequests—also is popularly suggested

# ***How much of the QSBS held in the IDGTs is still eligible for the exclusion?***

- All of the QSBS held in the springing partnership is disqualified as QSBS because §721 destroys QSBS treatment
  - *Maybe* an argument you can claw the QSBS back out of the partnership to refresh it, but that seems questionable
  - Take action to not let springing partnerships with QSBS be created by accident! Difficulty is that people love FLPs for valuation planning
- The QSBS held by an IDGT at death is more complicated
  - If §1015(a) applies to IDGT assets at death, no apparent issue (it's a gift)
  - If §1015(b) applies to IDGT assets at death, then apparently the deemed income tax transfer from the decedent is *neither* a gift, bequest, nor devise—is that still a good QSBS gift/at death transfer?

# **CASE STUDY: INSTALLMENT SALE**

# ***What are the two potential approaches on how Lynnette could exclude QSBS gain under the installment sale method?***

- Approach #1: Reporting the gain subject to exclusion under Section 1202 first
  - Plain language of Section 1202 supports exclusion-first (“gross income shall not include” gain from the sale of QSBS held over five years). Seller recognizes gain from the disposition of property when selling QSBS, so no apparent reason why the first (or earlier) payments would not be eligible for exclusion.
- Approach #2: Ratably reporting taxable gain and gain subject to exclusion under Section 1202
  - IRS favors ratable reporting approach based on the instructions to Form 1040 Schedule D, providing “Figure the allowable section 1202 exclusion for the year by multiplying the total amount of the exclusion by a fraction, the numerator of which is the amount of eligible gain to be recognized for the tax year and denominator of which is the total amount of eligible gain.”

# *What is her gain exclusion in year 1 and year 2 under each approach?*

- Approach #1 (Exclusion First):
  - Year 1: The full \$9.75M gain recognized
  - Year 2: The remaining \$250k in her \$10M per-taxpayer gain exclusion limit
- Approach #2 (Ratable Reporting):
  - Year 1: First \$5 million ( $\$10\text{M exclusion} \times \$9.75\text{M annual gain} / \$19.5\text{M total gain}$ )
  - Year 2: Last \$5 million (same as above)

# **CASE STUDY: TYPE OF ACQUIRER**

# *What's the difference between PE rollover management equity and public stock from a QSBS perspective?*

- Rollover management equity in a PE deal is generally a Section 721 transaction (tax-deferred transfer to a partnership). Public company stock would be taxable deal proceeds unless structured as a tax-deferred Section 368.
- For shareholders participating in the PE management rollover, this means sacrificing QSBS status by contributing a portion of those shares into a partnership.
- When QSBS is transferred for other stock in a Section 368 reorganization, the transferee treats the new stock received as QSBS, even if the new stock is not actually in a qualified small business, though the gain exclusion is then capped. Section 1202(h)(4).

# *Is there a way to preserve QSBS exclusion on the PE rollover equity?*

- Possibly, by structuring a cash-out on the QSBS in the deal and reinvestment to the management entity on a post-tax basis, rather than a contribution of shares that would taint QSBS status.
  - However, only tax efficient for shareholders basis in a state that conforms to 1202
  - California taxpayers would be triggering state income taxes on QSBS in the after-tax investment scenario
- In rare situations, sellers may be able to negotiate a newly formed C corporation as the management rollover entity for a Section 351 transfer to preserve QSBS benefits.

**CASE STUDY:  
GETTING TO FIVE YEARS WITH A §1045  
ROLLOVER**

# ***Could a §1045 rollover work for Jon's various reinvestments?***

- Direct stock acquisitions in a new start-up that is a QSB will work
  - Pay attention to active business rules for future QTBs
- Stock acquisitions done by a partnership in which Jon is a partner can be valid rollovers per Reg. §1.1045-1(c)
  - The Reg. does have traps and strange limitations
- Stock acquisitions done via stock options can work
- Convertible debt *may not work* as a rollover
  - Need to have §1012 cost basis (but for §1045) for rollover to work—§1045(b)(2)
  - Stock post-conversion gets substituted basis under Rev. Rul. 72-265, getting the debt's cost basis
  - Usually, substituted basis is not seen as §1012 cost basis

# *Can we extend the timeline for rolling over by spacing out Jon's receipt of sales proceeds?*

- The 60-day period for §1045 begins from the date of sale
- Installment sales:
  - The date an installment sale occurs is when the sale occurs, rather than when the payments occur
    - Compare authorities on §1042(c)(3) (not allowing stretch out for notes), §1031, §1033 .  
..
  - But the qualified opportunity zone rollover regulations *do* allow you to look to time of payment, not actual sale, in determining rollover period, even though the statute bases timing on date of sale or exchange
    - These are unusually favorable rules, however
- If you actually delay the sale, you have a better position

**CASE STUDY:  
GETTING TO FIVE YEARS THROUGH  
STRUCTURING**

# *Could we recapitalize into preferred stock to later liquidate?*

- The replacement preferred stock is probably not QSBS!
  - §1202(h)(3) applies rules similar to §1244(d)(2) applicable for §1202 purposes
    - Some ambiguity created by this cross-reference, since §1244(d)(2) only enables regulations, but view is that we probably use those regs for §1202
  - The §1244(d)(2) regs *do not* allow for preferred stock received in a recapitalization to qualify for §1244
  - Exception if the recap is caused by conversion under §1202(f)
- But even so, §1202(h)(4)(A) and (B) create partial QSBS treatment for replacement stock (up to the amount of rolled-over QSBS gain)
- Be careful of NQPS rules if planning into this
  - NQPS rules do not apply to family-controlled corporations in a recap—but note corp must stay family-controlled for three years after recap

# *What other ways exist to get money now but complete the sale later?*

- Certain short positions eliminate QSBS gain possibility (with exceptions for >5-year QSBS held when short entered into)
  - Short sales of substantially identical property
  - Options to sell substantially identical property
  - Other short positions “to the extent provide in regulations” (none exist yet)
- Thus, forwards apparently can get around this rule
  - But be careful of §1258 and §1259, depending on applicable facts
- May wish to get loan upfront (but must ensure no deemed sale from combined loan plus forward and other side deals)
- Variable prepaid forward contracts are a popular suggestion for threading the needle here and getting money upfront
- Installment sales do not delay date of actual sale and thus should not work

# *What if Jon is one of many shareholders owning their QSBS through an S corp?*

- Problem here is if S corp sells any QSBS, that gain must go to all shareholders
- Jon could sell his S corp shares to other shareholders and not get his QSBS; buyers also won't get basis step-up on any assets of S corp nor will be eligible for QSBS on gains flowing through the purchased shares
  - They could recover their basis on redemption or S corp liquidation
- Ideal (if feasible): Loan to Jon in interim, close loan with QSBS proceeds once they have hit five years
  - Practicalities likely to intervene