

Internal Revenue Code Section 1202(e)(3)

Partial exclusion for gain from certain small business stock.

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(e) Active business requirement.

(1) In general. For purposes of subsection (c)(2), the requirements of this subsection are met by a corporation for any period if during such period--

(A) at least 80 percent (by value) of the assets of such corporation are used by such corporation in the active conduct of 1 or more qualified trades or businesses, and

(B) such corporation is an eligible corporation.

(2) Special rule for certain activities. For purposes of paragraph (1), if, in connection with any future qualified trade or business, a corporation is engaged in—

(A) start-up activities described in section 195(c)(1)(A),

(B) activities resulting in the payment or incurring of expenditures which may be treated as research and experimental expenditures under section 174, or

(C) activities with respect to in-house research expenses described in section 41(b)(4), assets used in such activities shall be treated as used in the active conduct of a qualified trade or business. Any determination under this paragraph shall be made without regard to whether a corporation has any gross income from such activities at the time of the determination.



(3) Qualified trade or business. For purposes of this subsection, the term "qualified trade or business" means any trade or business other than—

(A) any trade or business involving 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 1 or more of its employees,

(B) any banking, insurance, financing, leasing, investing, or similar business,

(C) any farming business (including the business of raising or harvesting trees),

(D) any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A, and

(E) any business of operating a hotel, motel, restaurant, or similar business.

(4) Eligible corporation. For purposes of this subsection, the term "eligible corporation" means any domestic corporation; except that such term shall not include—

(A) a DISC or former DISC,

(B) a corporation with respect to which an election under section 936 is in effect or which has a direct or indirect subsidiary with respect to which such an election is in effect,

(C) a regulated investment company, real estate investment trust, or REMIC, and

(D) a cooperative.

(5) Stock in other corporations.

(A) Look-thru in case of subsidiaries. For purposes of this subsection, stock and debt in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiary's assets, and to conduct its ratable share of the subsidiary's activities.

(B) Portfolio stock or securities. A corporation shall be treated as failing to meet the requirements of paragraph (1) for any period during which more than 10 percent of the value of its assets (in excess of liabilities) consists of stock or securities in other corporations which are not subsidiaries of such corporation (other than assets described in paragraph (6)).

(C) Subsidiary. For purposes of this paragraph, a corporation shall be considered a subsidiary if the parent owns more than 50 percent of the combined voting power of all classes of stock entitled to vote, or more than 50 percent in value of all outstanding stock, of such corporation.

(6) Working capital. For purposes of paragraph (1)(A), any assets which—

(A) are held as a part of the reasonably required working capital needs of a qualified trade or business of the corporation, or

(B) are held for investment and are reasonably expected to be used within 2 years to finance research and experimentation in a qualified trade or business or increases in working capital needs of a qualified trade or business,

shall be treated as used in the active conduct of a qualified trade or business. For periods after the corporation has been in existence for at least 2 years, in no event may more than 50 percent of the assets of the corporation qualify as used in the active conduct of a qualified trade or business by reason of this paragraph.

(7) Maximum real estate holdings. A corporation shall not be treated as meeting the requirements of paragraph (1) for any period during which more than 10 percent of the total value of its assets consists of real property which is not used in the active conduct of a qualified trade or business. For purposes of the preceding sentence, the ownership of, dealing in, or renting of real property shall not be treated as the active conduct of a qualified trade or business.

(8) Computer software royalties. For purposes of paragraph (1), rights to computer software which produces active business computer software royalties (within the meaning of section 543(d)(1)) shall be treated as an asset used in the active conduct of a trade or business.

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