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Sent: 10/28/2010 4:16:11 PM
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Special tax benefits could help founders and investors

by Craig Sherman and Andrew Bryant on Tuesday, October 26, 2010, 9:10am PDT

Craig Sherman and Andrew Bryant: A little noticed provision of a recently enacted federal tax law may lead to a significant increase in the formation of new startups and angel investing before the end of this year. If you have been thinking about founding or investing in a technology startup, there is no better time to jump in and take advantage of a recently enacted federal income tax benefit.

President Obama recently signed into law changes to tax law that may, under certain circumstances, exempt profits from investments in startup companies from ALL federal income tax, including alternative minimum tax. Yes, that's right, if you start a new company now and sell it more than five years from now and make a \$10 million profit on the sale, you may owe NO federal income taxes on your profit.

This special tax benefit will apply only to stock issued to founders or investors between September 28 and December 31, 2010, so time is of the essence.

The founder or investor would have to buy and hold shares of a "qualified small business" for five or more years. A "qualified small business" is a C corporation engaged in an active trade or business with less than \$50 million in aggregate gross assets.

If you satisfy the above requirements and certain other conditions, you may not have to pay federal income taxes on your first \$10 million of gain. If there is a liquidity event within five years of your purchase of qualified small business stock, you may still be eligible to "roll over" any gains from sale of the shares tax-free within 60 days into another qualified small business.

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