34th Annual

Tax Symposium

QUALIFIED SMALL BUSINESS STOCK

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BACKGROUND

OVERVIEW

- Qualified Small Business Stock ("QSBS") is a tax incentive to drive the investment and establishment of small businesses in the United States
- The QSBS rules are governed under §1202 of the Internal Revenue Code of 1986, as amended ("Code")
- Per the legislative history, QSBS was intended to encourage the flow of capital to small businesses, many of which have difficulty attracting equity financing
- It is a mechanism for non-corporate shareholders to exclude a significant portion of their capital gains from federal income taxes when shareholders sell QSBS provided certain eligibility requirements are satisfied

HISTORY

- Omnibus Revenue Reconciliation Act of 1993
  - 50% and then 75% gain exclusion
- Small Business Jobs Act of 2010
  - Temporary 100% gain exclusion with extensions
- Protecting Americans From Tax Hikes Act of 2015
  - Permanent 100% gain exclusion (5-year or more holding period)
- The One Big Beautiful Bill Act of 2025
  - 50%/75%/100% gain exclusion (tiered 3, 4 and 5 year or more holding periods)

REQUIREMENTS FOR QSBS QUALIFICATION

A. QUALIFIED SMALL BUSINESS STOCK

- §1202(c) of the Code
- Any stock in a C corporation which is originally issued after the date of the enactment of the Revenue Reconciliation Act of 1993 (August 10, 1993), if: (a) as of the date of issuance, such corporation is a "***qualified small business***", and (b) such stock is acquired by the taxpayer at its "***original issue***"
- Acquisition of original issue stock

B. QUALIFIED SMALL BUSINESS

- §1202(d) of the Code
- Any domestic corporation which is a C corporation whose aggregate gross assets (treating all members of the same parent-subsidiary controlled group as one corporation):
  - (a) at all times before and immediately after the stock is issued (i) do not exceed $50,000,000 (for stock issued after August 10, 1993), and (ii) do not exceed $75,000,000 (for stock issued after July 4, 2025 as indexed for inflation after 2026); and
  - (b) such corporation agrees to submit such reports to the Secretary of the Treasury and to shareholders as the Secretary of the Treasury may require to carry out the purposes
- Reporting Requirements

C. ACTIVE BUSINESS AND QUALIFIED TRADE OR BUSINESS

- §1202(e) of the Code
- The corporation must be an "active business"
  - incorporated as a U.S. C corporation
  - at least 80% (by value) of the assets of the corporation are used by such corporation in the active conduct of one or more "qualified trades or businesses" and such corporation is an eligible corporation (any domestic corporation with certain exceptions)
- Qualified Trade or Business

D. QUALIFIED HOLDERS OF STOCK

- §1202(g) of the Code
- Type of Shareholder
- Special Pass–Through Benefits
- Gain Attribution

E. HOLDING PERIOD AND EXCLUSION AMOUNT

- §1202(A) of the Code

Summary of Changes	Prior law (stock acquired on or before July 4, 2025 but after August 10, 1993)	Modernized under OBBBA (stock acquired after July 4, 2025) by raising outdated thresholds and allowing investors to tap into §1202(A) in as little as 3 years
Holding Period	More than 5 Years	Shorter Holding Period - Now at least 3 Years
Tiered Gain Exclusion Percentages	• 100% for stock acquired after September 27, 2010 • 75% for stock acquired after February 17, 2009, and before September 28, 2010 • 50% for stock acquired before February 18, 2009 but after August 10, 1993	• 50% for stock held for 3 years • 75% for stock held for 4 years • 100% for stock held for 5 years or more
Cap on Gain Exclusion	Greater of: (i) $10 million; or (ii) 10 times the taxpayer's tax basis in the QSBS	Higher Asset Threshold and Bigger Exclusion Cap. Now it is the greater of: (i) $15 million (adjusted annually for inflation beginning after 2026); or (ii) 10 times the taxpayer's tax basis in the QSBS

- The portion of gain that remains taxable under the QSBS rules is subject to a 28% tax rate. rather than the standard 20% long-term capital gains rate. As a result, the effective tax rate is 14% for a 50% gain exclusion and 7% for a 75% gain exclusion, respectively (without considering the 3.8% net investment income tax)

ROLLOVER ELECTION FOR GAIN FROM SALE OF QSBS

ROLLOVER ELECTION (1 OF 2)

- § 1045 of the Code
- Permits shareholders to roll over (defer) gain from the sale of an original QSBS investment if the shareholder acquires replacement QSBS within 60 days after closing on the sale of the original QSBS
- The holding period for the original QSBS must be greater than six months
- This rollover election is most valuable for taxpayers who want to delay capital gains tax but have not yet met the holding period for the full gain exclusion
- The amount of the deferred gain reduces the basis in the new stock

ROLLOVER ELECTION (2 OF 2)

- Rules similar to §1202(g) for pass-through entities
- Tacking on holding period
- Original QSBS
- Replacement QSBS

PRACTICAL CONSIDERATIONS

A. CRITERIA

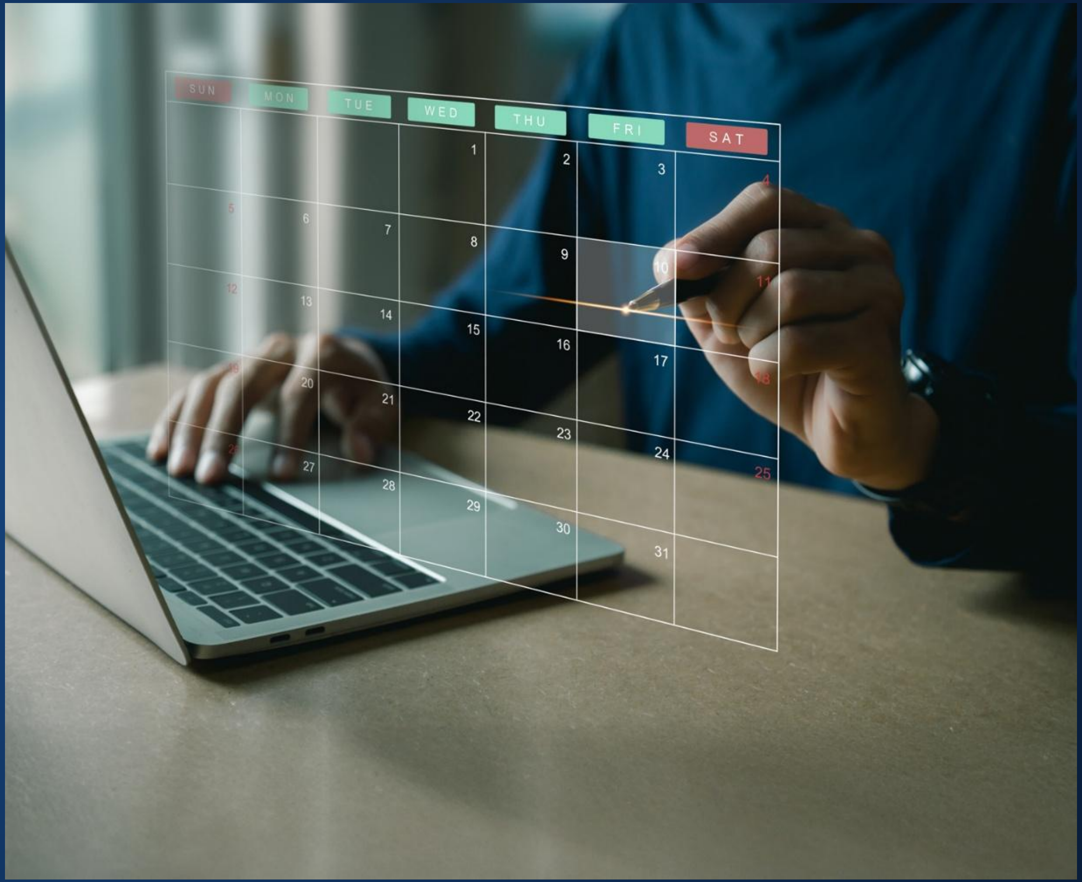
- C Corporation
- Gross Assets Test
- Active Business Requirement

B. STOCK ISSUANCE AND DOCUMENTATION

- Original Issuance
- Redemptions
- Stock Records

C. HOLDING PERIOD AND GAIN EXCLUSION

- Holding Period Pre and Post OBBBA
- Exclusion Amount Pre and Post OBBBA



D. EXIT AND TRANSACTION PLANNING

- Stock v Asset Sale
- Reorganizations

E. RECORDKEEPING AND AUDIT READINESS

- Entity Qualification
- Gross Assets Test
- Active Business
- Stock Issuance
- Redemption History

F. STATE AND FEDERAL COORDINATION

- Non-Conforming States
- §1045 – Rollover Planning

PRACTICAL PITFALLS

COMMON PRACTICAL PITFALLS

- Stock for services
- Conversion from LLC to C corporation
- Purchasing stock from other shareholders
- Redemptions or reorganizations within 2-year window
- Inadequate documentation
- State tax conformity

RECOMMENDED ACTIONS

RECOMMENDED ACTIONS FOR COMPANIES AND ADVISORS

- Plan early
- Maintain contemporaneous records
- Monitor business activities
- Review redemptions
- Coordinate with advisors

CONCLUSION

CORPORATE TRANSPARENCY ACT UPDATE

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THANK YOU

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