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The One Big Beautiful Bill Act Significantly Expands Qualified Small Business Stock Benefits

On July 4, 2025, President Donald Trump signed into law the One Big Beautiful Bill Act (OBBBA). Among the many changes to the tax law, the OBBBA marks a transformative enhancement of the Qualified Small Business Stock (QSBS) provisions under Section 1202 of the Internal Revenue Code (IRC). The expanded QSBS benefits offer substantial new opportunities for founders, investors, and emerging companies.

Under pre-OBBBA law, Code Sec. 1202 allowed noncorporate taxpayers that hold QSBS for more than five years to potentially exclude all, or part of the gain realized on the sale or exchange of that QSBS from gross income. Under the prior law, the amount of gain that was eligible for exclusion by a taxpayer with respect to QSBS held in a particular corporation is subject to an annual limitation equal to the greater of either: $10 million (reduced by the aggregate amount of eligible gain taken into account by the taxpayer in prior taxable years with respect to dispositions of QSB stock of such corporation); or 10 times the aggregate adjusted bases of QSB stock issued by such corporation and disposed of by the taxpayer during the taxable year. In addition, the aggregate gross assets of the issuing corporation (cash and the adjusted basis of its assets) generally must not have exceeded $50 million at any point before and immediately after the stock issuance (including amounts received in the issuance) at all times on or after August 10, 1993. The revisions made to Section 1202 of the IRC favorably modify these requirements, creating opportunities for future tax savings.

Key Amendments to QSBS Under OBBBA

Effective for stock issued after July 4, 2025, (the date of enactment) the OBBBA introduces three pivotal changes to QSBS rules:

1. **Tiered-Gain Exclusion:** The previous "five-year cliff" for 100% gain exclusion is replaced with a more flexible, tiered system for QSBS acquired after the enactment date. This allows for partial tax benefits at earlier holding periods:
    - **50% exclusion** for QSBS held for at least three years but less than four years.
    - **75% exclusion** for QSBS held for at least four years but less than five years.
    - **100% exclusion** for QSBS held for at least five years.

    This tiered approach provides opportunity for founders and investors who desire to hold their QSBS on shorter time horizon, offering substantial tax savings even with earlier liquidity events.

2. **Increased Per-Issuer Gain Exclusion Cap:** The per-issuer gain exclusion cap is raised from $10 million to $15 million. This increased cap will also be adjusted for inflation starting in 2027.

3. **Enhanced Aggregate Gross Assets Threshold:** The corporate-level aggregate gross asset threshold for qualifying as a small business is increased from $50 million to $75 million. This threshold will also be adjusted for inflation beginning in 2027.

It is crucial to note that investments made in QSBS prior to the enactment date will still only benefit from the current per-issuer cap of $10 million, even if sold after the new legislation takes effect.

Table: Key QSBS Changes Under OBBBA (Current Law vs. New Provisions)

Parameter	Prior Law (Stock acquired before Effective Date)	OBBBA Provisions (Stock acquired after Effective Date)
Holding Period for Exclusion	More than five years for 100% exclusion; 50% or 75% for earlier acquisitions	Tiered: three years (50%), four years (75%), five+ years (100%)

Per-Issuer Gain Exclusion Cap	Greater of $10 million (or $5 million for MFS) or 10x basis	Greater of $15 million (or $7.5 million for MFS), adjusted for inflation from 2027, or 10x basis
Aggregate Gross Assets Threshold	$50 million	$75 million, adjusted for inflation from 2027
Effective Date	N/A (Applies to stock acquired on or before OBBBA enactment	Stock issued / acquired and tax years beginning on or after OBBBA enactment date

Strategic Implications and Planning Opportunities

These amendments carry significant strategic implications for various stakeholders:

- **For Founders and Investors:** The tiered-gain exclusion provides crucial flexibility, de-risking early-stage investments by allowing for partial tax benefits even if an exit occurs before the five-year mark. This could encourage increased capital formation, and investment in startups.
- **For Emerging Companies:** The higher $75 million asset threshold offers significant "additional headroom" for companies to raise more capital and grow larger before hitting the QSBS asset ceiling. This extends the period during which they can issue QSBS-eligible stock, supporting entrepreneurship and facilitating M&A transactions.

Recommendations for Clients

To effectively navigate this updated tax landscape and maximize the benefits offered by the expanded QSBS provisions, we recommend the following:

- **Proactive Planning:** Immediately review your current and planned QSBS holdings. Also, re-think whether QSBS could be a good fit for your business structure.
- **Rigorous Documentation:** The IRS is expected to scrutinize QSBS claims more rigorously. Maintain comprehensive records and obtain QSBS attestation letters from issuing corporations to meticulously substantiate every eligibility requirement.

- **Professional Consultation:** Engage with experienced tax advisors to develop tailored strategies. This includes optimizing the timing of sales, evaluating Section 1045 rollovers, and integrating QSBS into broader gift and estate planning. Be aware that state tax treatment of QSBS varies, and federal changes do not automatically apply at the state level.

The OBBBA represents a significant opportunity for those involved in the small business and startup ecosystem. We encourage you to consult with your tax advisor to understand how these changes specifically impact your investments and business strategies.

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