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What If I Told You…That You Didn't Have to Pay Taxes When You Sell This Stock?

The One Big Beautiful Bill Act (OBBBA) was enacted into law on July 4, 2025. Many of the items included in the final legislation were a "make permanent" of items which had been previously included in the Tax Cuts and Jobs Act of 2017 during the first Trump presidential term, and which were set to expire (or "sunset") at the end of this year. However, this new legislation both expands on some of the provisions in the 2017 Act as well as creates new tax incentives.

President Trump and the Republican majority Congress as a matter of policy like to promote business and the interests of business owners, and since our federal tax laws are used to both promote and discourage certain actions of taxpayers, much of the newly enacted tax law is favorable to those businesses and their owners alike.

This article will focus one update in particular which was included in the legislation – the expansion of the definition of Section 1202 of the tax code, "Qualified Small Business Stock". We will discuss a brief history what QSBS is, and what it means to qualify as this type of small business stock. We will also examine the newly expanded gain exclusion, explore considerations for various entity types, as well as review some potential planning techniques.

A Brief History of the Definition of Qualified Small Business Stock, and the Formula for Exclusion of Gain on Sale

Section 1202 of the Internal Revenue Code was created in 1993 during the Clinton Administration as an incentive for non-corporate taxpayers to invest in early-stage businesses. The code section created a definitional based exclusion of gain realized on the sale of **Qualified Small Business Stock (QSBS).** Below is a brief timeline for some of the key historical developments[1]:

- **1993: Initial Enactment.** Congress enacted Section 1202 as part of the Taxpayer Relief Act, allowing a 50% exclusion from gross income for gains on the sale of QSBS.
- **2009: 75% Exclusion.** In response to the financial crisis, the American Recovery and Reinvestment Act temporarily increased the exclusion to 75% for stock acquired after February 17, 2009.
- **2010: 100% Exclusion.** The Small Business Jobs Act of 2010 temporarily increased the exclusion to 100% for stock acquired after September 27, 2010[2].
- **2015: Permanent 100% Exclusion.** The Protecting Americans from Tax Hikes (PATH) Act of 2015 made the 100% exclusion permanent for stock issued after September 27, 2010.
- **2017: TCJA and Increased Popularity.** The Tax Cuts and Jobs Act of 2017 lowered the corporate tax rate from a maximum 35% to a flat 21%, making the C corporation structure (the type of entity that qualifies as QSBS) more attractive as an entity type.

- **2025: One Big Beautiful Bill Act (OBBBA).** The recently enacted OBBBA introduced the following changes, and expanded the definition for QSBS issued after July 4, 2025:
    - Tiered exclusion correlated to shorter holding periods: 50% exclusion for stock held at least three years, 75% for four years, and 100% for five years.
    - Increased per-issuer limitation: The $10 million cap (discussed below) was increased to $15 million and indexed for inflation.
    - Increased gross asset threshold: The limit for qualifying small businesses was increased from $50 million to $75 million (also discussed below).

A **Qualified Small Business (QSB)**, which issues QSBS, is defined as [3]:

1. A C corporation formed in the U.S., including an entity formed under state law as an LLC, which has "checked the box" to be taxed as a corporation, can issue QSBS [4].
2. An entity with cash and other assets not more than $75 million (based on cost basis, not value), indexed for inflation, where the taxpayer acquired the stock on original issuance from the corporation.
3. The QSB must be engaged in any business not excluded from eligibility [5].
4. An entity with an active trade or business where at least 80% of its assets are deployed to run the business, and not for passive investment.

Should a taxpayer acquire and subsequently sell QSBS meeting all the criteria set forth above, the taxpayer **may exclude from gross income gain on sale equal to the greater of $15 million, or ten times the aggregate basis of all the QSBS sold in the taxable year.**

Entity Types and Considerations – Is a C Corp right for you?

QSBS includes only stock in a C corporation, and therefore that entity type is required for any QSBS planning. However, as previously mentioned a state law LLC which has "checked the box" to elect C Corp status can still issue QSBS – the five year period for full exclusion will therefore begin on the date in which the election was made, and not when the LLC was created and funded.

When the Tax Cuts and Jobs Act of 2017 lowered the corporate tax rate to a flat 21%, it provided an even greater incentive to at least consider QSBS planning. But as we often warn, we must not let the "tax tail wag the dog". There are other considerations which need to be addressed prior to creating and electing a specific entity type. A full list of potential issues would be lengthy, and each person should seek particular advice prior to selecting a type; however some basic questions related to QSBS planning are:

1. Do you plan to make distributions of profits from the business? If so, perhaps there are other entity types which would better fit your profile considering the double taxation of C corps (distributions are not deductible to the corporation and are taxed to the individual owner as a dividend).
2. What is the projected timeframe for operating the business? Although the OBBBA has loosened the restrictions on utilizing the gain exclusion, allowing for potential partial exclusions, the 100% exclusion is only allowed after a 5-year hold.
3. Does the business have a want or a need for outside capital? If so, selling stock or completing a capital raise will likely provide simpler with a C Corp structure versus a partnership or an S Corp given the various limitations and restrictions on those other types of entities.
4. Many eventual sales of privately held businesses are in the form of a sale of assets, not the stock. The gain exclusion only applies to stock sales, which could complicate negotiations with a potential buyer.

Since the Qualified Business Income Deduction (QBID) (applicable to owners of pass-through entities and designed to roughly equate the tax rate on C corporation income with individual tax rates on S corporation and partnership income) was also made permanent in the OBBBA, choosing a C Corp cannot and should not be based on tax rates alone. However, starting and funding a projected high growth business naturally lends itself to a plan for the creation and eventual sale of a Qualified Small Business in C corporation despite the double taxation issue.

Planning Techniques Utilizing Qualified Small Business Stock – Doing "Anything" to Avoid Tax?

As previously stated, one of the requirements to maintain status of QSBS is "original issue" by the C corporation. There are plenty of ways to fail this requirement, and you should consult with your advisors to proactively confirm that these conditions are met.

The key terminology to which I want to draw a clear distinction is "each taxpayer". Each taxpayer who owns originally issued stock from a Qualified Small Business and who has held the shares for at least five years (in order to receive the maximum benefit) may exclude gains on the sale of those shares. There are certain extensions of who qualifies as a person receiving original stock issuance.
For QSBS purposes, shares which have been received by gift shall receive the same treatment as the donor. In other words, if a donor purchased originally issued QSBS and gifted those shares to family members, those family members would receive carryover basis treatment, holding period, and status as the original owner. In this case then, each family member could qualify for the gain exclusion. Note that a sale of stock, instead of a gift, would not work.

Should outright gifts to individuals not be preferred for various reasons, such as the desire to restrict access or control, gifting to trusts may be utilized successfully as well. Properly designed trusts, where separate trusts are created for each family member or beneficiary, can expand the number of shareholders of the C corporation who then each have status as a holder of QSBS with separate gain limitations. Other very technical requirements of the trusts must be met; careful planning is required.

The concept of what is a separate taxpayer is gray and has led some practitioners to wonder whether that applies to married persons filing joint returns. Are two spouses who file jointly considered one taxpayer for QSBS purposes, or two separate taxpayers? It is not completely clear from the wording of the legislation, and the answer could vary based on the advisor. The client's appetite for risk of audit must be considered. What if one spouse gifted shares to another? What if, in an unlikely yet still possible scenario two spouses each owned QSBS in the same business, and after the time which they acquired these shares, they got married? These hypotheticals make it possible to imagine a scenario in which one could make a reasonable argument that each spouse ought to be considered a separate taxpayer for QSBS purposes – unless you live in a community property state. If you do not, it is very uncertain.

Death and divorce also are events that can cause transfer of QSBS without impacting the "original issuance" requirement. Since a step-up in basis occurs upon death and applies to the QSBS included in the estate, this means that for the heir of the deceased, the basis step-up may negate the need for planning for gain exclusion under Section 1202, especially where there is a likelihood that the business founder may not sell during life. However, the basis step-up at death is not a complete replacement for the QSBS gain exclusion and the basis limitation calculation.

For example, assume the deceased acquired in an original issuance shares of a QSB for $1 million and held the shares for over 5 years. At the time of death, those shares had increased in value to $20 million. If the beneficiary of the estate sold the shares immediately, the basis for income tax purposes would have stepped up to date of death value, and there would be little to no gain on sale. However, if the estate beneficiary retained the shares and the value increases to $200 million, the maximum gain exclusion would still be limited under the new OBBBA law to the greater of $15 million or ten times the original stock basis (10 x $1 million = $10,000,000) and that calculation would not include the date of death step-up in basis. Therefore, $15 million would be excluded under Section 1202 from gain in this example, and the remainder of the gain (FMV less date of death stepped up basis) would be subject to capital gains tax.

The idea of divorce is an interesting one – purely from a planning perspective. This is not advice, particularly coming from someone recently married in the past year, but I can't help but wonder who the first advisor would be to recommend to their clients to simply "get divorced" to take advantage of maximizing the QSBS exclusion, assuming the more conservative reading of the law that married persons are not treated as separate shareholders. Crazier things have happened, I would assume – and it would really put the concept of doing "anything" to avoid taxes to the test.

In closing, Section 1202 can provide for some potentially large benefits for those who are looking to create a small business or businesses. High growth businesses do not just happen only in the tech industry, and if intentionally planned, the expansion of Section 1202 in the OBBBA, and the increased potential tax benefits, could create a new wave of C Corp businesses over the coming years.

[1] https://www.google.com/search?q=history+of+section+1202&rlz=1C1CHBF_en&oq=history+of+section+1202&gs_lcrp=EgZjaHJvbWUyBggAEEUYOTINCAEQABiGAxiABBiKBTINCAIQABiGAxiABBiKBTINCAMQABiGAxiABBiKBTIKCAQQABiiBBiJBTIHCAUQABjvBTIKCAYQABiABBiiBDIKCAcQABiABBiiBDIKCAgQABiABBiiBNIBCDU3ODlqMGo3qAIAsAIA&sourceid=chrome&ie=UTF-8
[2] Federal Law Excludes 100% of Gains on Qualified Small Business Stock Acquired By December 31, 2010
[3] https://frblaw.com/obbba-series-qualified-small-business-stock/
[4] https://frostbrowntodd.com/to-be-clearllcs-can-issue-qualified-small-business-stock-qsbs/
[5] Section 1202(e)(3) provides, in relevant part, that a qualified trade or business means any trade or business other than (A) a 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 one or more of its employee.

Author: Mac McLaughlin, CFP®, Senior Wealth Advisor, Managing Director, Wellspring Financial Advisors, LLC
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