Expanded QSBS Benefits Under the One Big Beautiful Bill Act

By Alexis J. Kim

The One Big Beautiful Bill Act (Pub. Law 119-21) (the "Act"), which was signed into law on July 4, 2025, expanded the potential tax benefits for sales of Qualified Small Business Stock ("QSBS") under Section 1202 of the Internal Revenue Code of 1986, as amended (the "Code"). If certain requirements are met, Section 1202 of the Code allows noncorporate shareholders who sell QSBS to exclude some or all of their gain from gross income, potentially realizing a significant tax savings.

Startup venture investors and early-stage business owners may be able to benefit from the expanded Section 1202 gain exclusion for newly issued stock and C corporations may see renewed interest from investors who would like to benefit from the expanded Section 1202 gain exclusion. These changes do not modify the tax benefits available for QSBS that was issued on or before the enactment date of the Act.

Previously Issued QSBS

For stock issued on or before July 4, 2025, a shareholder may exclude between 50% and 100% of their eligible gain (depending on the stock issuance date) on a sale of QSBS that was held for more than 5 years. Such exclusion is limited to the greater of 10 times their stock basis or $10 million (per corporation). QSBS must be originally issued stock of a C corporation that has had aggregate gross assets not in excess of $50 million at all times prior to and immediately after the stock issuance date. Various additional requirements are imposed by Section 1202 that must be met by both the corporation and the shareholder in order to qualify for the QSBS gain exclusion, some of which are listed at the end of this article.

Newly Issued QSBS

The Act modifies the Section 1202 requirements as follows for taxable years beginning after July 4, 2025 (except as otherwise indicated below):

- Exclusion percentage based on length of holding period.
  - The Act creates a new phased-in exclusion rate for shareholders who hold their stock for 3 or more years at the time of a stock sale.
  - QSBS in excess of the exclusion rate is subject to a 28% capital gains rate while a sale of stock other than QSBS (held for more than 1 year) is subject to a maximum 20% capital gains rate. The effective tax rate for QSBS held for 3 years or more under the new Section 1202 requirements is shown on the table below, not including the Net Investment Income Tax. For comparison, this table includes the 100% exclusion rate for stock issued after September 27, 2010, and on or before July 4, 2025, and held for more than 5 years.

Holding Period	Exclusion Rate for QSBS Issued on or before July 4, 2025	Effective Tax Rate for QSBS Issued on or before July 4, 2025	Exclusion Rate for QSBS issued after July 4, 2025	Effective Tax Rate for QSBS issued after July 4, 2025
3 Years	0%	20%	50%	14%
4 Years	0%	20%	75%	7%
5 Years	100%*	0%	100%	0%

*Technically, the 100% exclusion rate for stock issued after September 27, 2010, and on or before July 4, 2025, must be held for *more* than 5 years.

  - As shown in the table, an investor may now be able to reduce their taxable gain on the sale of stock held for only 3 or 4 years for newly issued QSBS. This tax benefit may attract additional investors to startup ventures that anticipate quick growth and an exit before the 5-year holding period is met.

- Gain limitation amount increased to $15 million.
  - Effective for stock issued after July 4, 2025, a shareholder will be permitted to exclude gain equal to the greater of $15 million or 10 times their stock basis on the sale of QSBS.
  - The $15 million gain limitation will be adjusted annually for inflation.
  - The $10 million gain limitation continues to apply to stock issued on or before July 4, 2025 and is not adjusted for inflation, essentially locking in prior law for stock issued before the Act.
  - The new, higher gain limitation amount will allow investors in successful startup ventures a greater potential upside on a stock sale.

- Aggregate gross assets test increased to $75 million.
  - Effective for stock issued after July 4, 2025, a C corporation may issue QSBS if it has had aggregate gross assets not in excess of $75 million at all times prior to the stock issuance and also immediately after the issuance of QSBS.
  - This amount was intended to be adjusted annually for inflation, however, due to a typo in the Act's language, the Act added the inflation adjustment provision to the wrong subsection of 1202. Congress may correct this typo in future legislation.
  - The increased aggregate gross assets test will allow startup ventures to attract investors who want QSBS treatment for a longer period of time during the corporation's growth phase.
  - Since the increased aggregate gross assets test is effective for stock issued after July 4, 2025, a corporation that had previously met the old $50 million aggregate gross assets test but has remained below the $75 million aggregate gross assets test may now be able to issue additional QSBS to investors.

Corporations and potential investors should keep in mind that the threshold requirements for stock to qualify as QSBS have not changed, other than as specified above. This article is not intended to provide a detailed explanation of the QSBS requirements, however, some of these requirements include: (i) stock must be originally issued by a C corporation to a non-corporate shareholder in exchange for property or as compensation for services; (ii) the corporation must conduct an active trade or business in a qualified business activity; (iii) the corporation must remain a C corporation during substantially all of the shareholder's holding period; (iv) certain transfers and redemptions can disqualify a shareholder's stock from being eligible for QSBS treatment; and (v) stock transfers and corporate restructuring may also disqualify a shareholder's stock from being eligible for QSBS treatment. Additionally, in order to obtain the full benefit of Section 1202, the shareholders must sell the QSBS. This means that the ideal exit event is a stock sale and not an asset sale by the corporation.

Investors who are interested in utilizing Section 1202 to exclude gain on a future sale should consult with their tax advisors and consider all the qualification requirements before making an investment and track any changes during their holding period that may affect qualification. Corporations should be prepared to provide information to shareholders to allow them to document whether the corporate-level requirements for Section 1202 have been met.

For More Information

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