Consider the tax advantages of investing in qualified small business stock

While the Tax Cuts and Jobs Act (TCJA) reduced most ordinary-income tax rates for individuals, it didn't change long-term capital gains rates. They remain at 0%, 15% and 20%.

The 0% rate generally applies to taxpayers in the bottom two ordinary-income tax brackets (now 10% and 12%), but you no longer have to be in the top ordinary-income tax bracket (now 37%) to be subject to the top long-term capital gains rate of 20%. Many taxpayers in the 35% tax bracket also will be subject to the 20% rate.

So finding ways to defer or minimize taxes on investments is still important. One way to do that — and diversify your portfolio, too — is to invest in qualified small business (QSB) stock.

QSB defined

To be a QSB, a business must be a C corporation engaged in an active trade or business and must not have assets that exceed $50 million when you purchase the shares.

The corporation must be a QSB on the date the stock is issued and during substantially all the time you own the shares. If, however, the corporation's assets exceed the $50 million threshold while you're holding the shares, it won't cause QSB status to be lost in relation to your shares.

2 tax advantages

QSBs offer investors two valuable tax advantages:

1. Up to a 100% exclusion of gain. Generally, taxpayers selling QSB stock are allowed to exclude a portion of their gain if they've held the stock for more than five years. The amount of the exclusion depends on the acquisition date. The exclusion is 100% for stock acquired on or after Sept. 28,

2010. So if you purchase QSB stock in 2018, you can enjoy a 100% exclusion if you hold it until sometime in 2023. (The specific date, of course, depends on the date you purchase the stock.)

2. Tax-free gain rollovers. If you don’t want to hold the QSB stock for five years, you still have the opportunity to enjoy a tax benefit: Within 60 days of selling the stock, you can buy other QSB stock with the proceeds and defer the tax on your gain until you dispose of the new stock. The rolled-over gain reduces your basis in the new stock. For determining long-term capital gains treatment, the new stock’s holding period includes the holding period of the stock you sold.

More to think about

Additional requirements and limits apply to these breaks. For example, there are many types of business that don’t qualify as QSBs, ranging from various professional fields to financial services to hospitality and more.

Before investing, it’s important to also consider nontax factors, such as your risk tolerance, time horizon and overall investment goals. Contact us to learn more about QSB stock.