
# Investing in qualified small business stock now offers expanded tax benefits

By purchasing stock in certain small businesses, you can diversify your investment portfolio. You also may enjoy preferential tax treatment, some of which is getting even better under the One Big Beautiful Bill Act (OBBBA) that was signed into law in July: Qualified small business (QSB) stock now offers more tax-saving opportunities.

**QSB defined**

A QSB generally is a U.S. C corporation that meets two requirements, one of which has been eased by the OBBBA to allow more businesses to qualify:

**1. It must be engaged in an active trade or business.** A qualified active business is generally any trade or business *other than*:

- Service businesses in the following fields: health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services and brokerage services,
- Banking, insurance, financing, leasing, investing and similar businesses,
- Farming businesses,
- Certain oil, gas and mining businesses, and
- Operators of hotels, motels, restaurants and similar businesses.

Additionally, the company must use at least 80% of its assets (by value) to conduct one or more qualified active businesses. And no more than 10% of its assets can consist of nonbusiness real estate.

**2. It must have assets below a certain ceiling.** Before the OBBBA, the business's aggregate gross assets generally couldn't exceed $50 million. The OBBBA increases the asset ceiling to $75 million (adjusted for inflation after 2026) for stock issued after July 4, 2025.

If the issuer owns more than 50% of another corporation's stock, the subsidiary's assets are included for purposes of the gross asset test. A corporation isn't disqualified if its assets grow beyond the threshold after issuing the stock.

### A valuable gain exclusion

When QSB stock tax breaks were initially introduced, you could exclude 50% of your capital gain from the sale of QSB stock if you'd held it at least five years. Subsequently, Congress enhanced the exclusion. If you acquired QSB stock after February 17, 2009, and before September 28, 2010, 75% of the gain is excludible after the five-year holding period. If you acquired it on or after September 28, 2010, the exclusion is 100% after five years.

Now the OBBBA provides new, but smaller exclusions for QSB stock held for shorter periods. Specifically, it provides a 75% exclusion for QSB stock held for four years and a 50% exclusion for QSB stock held for three years. These exclusions go into effect for QSB stock acquired after July 4, 2025.

If the QSB stock is received by gift or inheritance, the transferor's holding period is added to the recipient's.

### Additional rules

To qualify for the gain exclusion, generally you must acquire the stock as part of an original issuance. In other words, you must acquire it directly from the corporation (or through an underwriter) — not from an existing shareholder — in exchange for money or property (other than stock) or as compensation for services. This requirement has some exceptions, including for stock received by gift or inheritance.

There is also a limit on the size of the exclusion. The amount of QSB gain on a particular issuer's stock that you may exclude each year is limited to the *greater* of $10 million or 10 times your aggregate adjusted tax basis in stock sold during the tax year.

Finally, be aware that some states don't offer QSB gain exclusions. So state-level taxes may still apply.

**One more opportunity**

If within 60 days of selling QSB stock you buy other QSB stock with the proceeds, you can defer any 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.

Similar rules apply if QSB stock is converted into a different stock of the same corporation. The original stock's holding period is added to the new stock's holding period.

**Consider carefully**

QSB stock offers some significant tax benefits. But, as when contemplating any investment, you must think about more than just taxes. You should also consider factors such as your investment goals, time horizon and risk tolerance. Contact us to discuss the tax implications in more detail.