



Unlock tax-free gains with QSB stock

If you run your business as a C corporation, you may be eligible for a potentially significant tax break for qualified small business (QSB) stock. This opportunity has existed for years, but recent tax law changes have enhanced it.

What's a QSB corporation?

QSB corporations are a special type of C corporation. At the entity level, QSB corporations are generally treated as regular C corporations for legal and federal income tax purposes. So, most of the standard advantages and disadvantages of C corporation status apply equally to QSB corporations, including the 21% flat federal income tax rate on corporate income. However, QSB *shareholders* can potentially enjoy a significant tax advantage: A special gain exclusion rule can allow them to avoid the federal income tax hit on up to 100% of the gain from selling QSB stock.

C corporations that own QSB stock aren't eligible for the gain exclusion. But sales of QSB stock held by pass-through business entities — such as S corporations, partnerships and, typically, limited liability companies — may be eligible. The break is effectively passed through to individual pass-through entity owners.

Which shares qualify as QSB stock?

To be eligible for the QSB stock gain exclusion, several requirements must be met, including the following:

- You must acquire the shares upon original issuance by the corporation or by gift or inheritance.
- The corporation must be a QSB corporation on the date the stock is issued and for substantially all the time you own the shares. Among other things, this means it must not have assets that exceed \$75 million (\$50 million if the stock was issued on or before July 4, 2025). The \$75 million limit will be indexed for inflation after 2026.
- The corporation must actively conduct a qualified business. Service businesses and certain other businesses don't qualify. (Contact us for a complete list of nonqualified businesses.)

Timing is also critical. To take advantage of the 100% gain exclusion for sales of QSB stock, you must have acquired the shares after September 27, 2010, and held them for at least five years.

How did the OBBBA expand the exclusion?

In addition to raising the QSB asset ceiling, the One Big Beautiful Bill Act (OBBBA) enhanced the gain exclusion rules for QSB shares acquired after July 4, 2025. It allows a 50% gain exclusion for QSB stock held for at least three years and a 75% gain exclusion for QSB stock held for at least four years. The 100% gain exclusion still applies to QSB stock held for at least five years.

For QSB shares acquired after July 4, 2025, your excludable gain for any year is limited to the *greater* of:

- 10 times your aggregate tax basis in the QSB stock that was sold, or
- \$15 million (\$7.5 million if you were married but filed separately), reduced by the amount of gain you excluded in prior tax years from sales of QSB stock issued by the same corporation.

When the \$15 million (or \$7.5 million) restriction applies, it's effectively a lifetime limitation.

Next steps

The gain exclusion for QSB stock and the flat 21% corporate federal income tax rate are two powerful incentives to operate a business as a QSB corporation. You can potentially convert an existing unincorporated business into a QSB corporation by incorporating it. Contact us to learn more about this tax-saving strategy. We can help you navigate the complex rules and requirements.

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