

# Expanded Opportunities for Qualified Small Business Stock After OBBBA

## Introduction

Qualified Small Business Stock (QSBS) has been one of the more generous provisions in the Internal Revenue Code since its enactment in 1993. For entrepreneurs, founders, family business owners and early investors, Section 1202 of the Internal Revenue Code offers the potential to exclude a large portion of gains realized from the sale of eligible stock from federal income tax which may improve after-tax returns and incentivize investment in small businesses.

The One Big Beautiful Bill Act (OBBBA), signed into law on July 4, 2025, significantly enhances the tax benefits associated with QSBS under Section 1202 of the Internal Revenue Code. Key changes for QSBS acquired after July 4, 2025, include, reduced holding periods offering earlier tax relief, increased cap on exclusions, and expands company eligibility to participate in QSBS. These changes open up new opportunities and introduce new layers of complexity for founders raising capital as well as investors evaluating exit strategies.

This paper describes QSBS, explores strategic implications for entrepreneurs and investors alike, and highlights the changes following the OBBBA.

## QSBS Basics

**What is the benefit?** – Depending on when QSBS is acquired, different amounts of gain can be excluded from federal taxation when QSBS is sold. For QSBS acquired before July 5, 2025, taxpayers can exclude up to the greater of \$10 million or 10 times their adjusted basis in QSBS when the stock is sold if it is held more than five years; depending on the date of issuance, the percentage of excluded gain ranges from 50% to 100% (see table below). For QSBS acquired after July 4, 2025, the exclusion is increased to the greater of \$15 million (adjusted for inflation starting in 2027) or 10 times basis and this expanded exclusion applies at 50% for QSBS held three years, 75% for QSBS held four years, and 100% for QSBS held five years. The exclusions are on a per issuer basis, meaning if one owns QSBS in more than one company, the stockholder gets a separate exclusion for each company.

**Who qualifies?** QSBS must be issued by a domestic **C corporation** directly to the taxpayer (not purchased in a secondary transaction). The issuing corporation must be actively engaged in a qualifying trade or business at the time of issuance and during substantially all of the taxpayer's holding period. The company's **gross assets** must not exceed the statutory threshold (\$50 million historically; \$75 million under OBBBA for stock issued after July 4, 2025, adjusted for inflation starting in 2027).

### Investment and Insurance Products are:

- **Not Insured by the FDIC or Any Federal Government Agency**
- **Not a Deposit or Other Obligation of, or Guaranteed by, the Bank or Any Bank Affiliate**
- **Subject to Investment Risks, Including Possible Loss of the Principal Amount Invested**

**Who does not qualify?** Certain types of businesses are specifically excluded under §1202(e)(3), including: **Professional services** (healthcare, law, engineering, architecture, accounting, consulting, athletics, performing arts); **financial services and brokerage services** (banking, insurance, financing, leasing, investing, etc.); **farming and natural resource extraction**; **hospitality and food services** (hotels, motels, restaurants, and similar businesses).

## Strategic Implications

**For Founders and Businesses** strategic implications fall into three areas: (1) **Capital raising** - more mid- and growth-stage companies now qualify to issue QSBS, increasing the appeal of their stock to investors; (2) **Exit planning** - shorter holding periods align more closely with real-world growth and liquidity cycles; (3) **Compliance** - documentation of asset levels, business activity, and corporate actions remains important to preserve eligibility.

**For Investors** there are even more strategic implications: (1) **Portfolio strategy** - earlier partial exclusions may reduce risk and allow more dynamic exit timing; (2) **Due diligence** - QSBS eligibility should be evaluated early in deal screening; (3) **Per-issuer/per-taxpayer benefit** - exclusion limits apply separately to each company and each taxpayer, potentially multiplying benefits across a portfolio; (4) **Fund structuring** - venture and private equity funds may revisit structures and holding periods to maximize QSBS advantages; (5) **1045 rollovers** - an additional tool to help maintain QSBS eligibility including when a sale occurs before the holding period ends.

## Multiplying the effect with stacking and splitting

**Gifts to family members or trusts:** Gifting QSBS to multiple family members or non-grantor trusts (sometimes called “stacking”) requires proactive planning, but when executed correctly, it can amplify QSBS tax benefits because each taxpayer qualifies for their own exclusion - each donee can potentially claim their own \$10M (pre-OBBBA) or \$15M (post-OBBBA) exclusion. Professional advice is important as transfers must be structured carefully to avoid gift tax or disqualifying the QSBS status. Trusts should be designed as separate taxpayers (non-grantor trusts) to help ensure distinct exclusion limits, acquisition date(s), basis, and corporate documentation is essential.

**Charitable component:** QSBS owners may also donate QSBS to a charitable remainder trust (CRT) for potential additional exclusion.

**Splitting:** Due to the wording of Internal Revenue Code Section 1202, proper planning and splitting the QSBS sale over two years may allow the two different exclusion calculations to both be used. For example, assume a taxpayer creates a business and holds all the company shares, which satisfy the requirements to qualify as QSBS and for the 100% exclusion. The taxpayer could sell some of the QSBS shares in year 1 and shelter up to \$10,000,000 of gain from taxation. In the following year the investor could sell additional QSBS shares, and shelter gain equal to up to 10 times the aggregate adjusted basis of the stock sold in that subsequent year from gain.

## What Changed Under OBBBA

The following changes apply to stock issued **after July 4, 2025**:

- **Corporate Asset Limitation:** Raised from \$50 million to \$75 million, inflation adjusted going forward.

- **Per-Issuer Limitation:** Increased from \$10 million to \$15 million or 10 times the taxpayer’s cost basis, indexed for inflation starting in 2027.
- **Graduated Holding Period:** Allows 50% exclusion after 3 years, 75% after 4 years, and 100% after 5 years.
- **Alternative Minimum Tax (AMT) Exception:** Gains under the new exclusion tiers are **not AMT tax** preference items.
- **Inflation Indexing:** Both the asset cap and \$15 million gain exclusion limit will be adjusted annually for inflation starting in 2027.

## But What About Stock Acquired before OBBBA?

QSBS shares issued before July 5, 2025 remain subject to the prior rules, while the new OBBBA provisions apply only to stock issued **on or after July 5, 2025**. Following is a comparison table to assist QSBS owners align their holdings into the appropriate “rule set” and help understand both the exclusion percentage and the required holding period.

### QSBS Benefits by Issuance Period

Issuance Period	Exclusion %	Holding Period	Gain Cap	Effective Tax Rate for Gain at Cap <sup>1</sup>
Aug 11, 1993 – Feb 17, 2009	50%	5 years	Greater of \$10M or 10× basis	15.9% *7% of excluded gain is an AMT preference item*
Feb 18, 2009 – Sep 27, 2010	75%	5 years	Greater of \$10M or 10× basis	7.95% *7% of excluded gain is an AMT preference item*
Sep 28, 2010 – Jul 4, 2025	100%	5 years	Greater of \$10M or 10× basis	0%
After July 4, 2025	50% / 75% / 100%	3 yrs = 50% 4 yrs = 75% 5 yrs = 100%	Greater of \$15M (indexed for inflation starting in 2027) or 10× basis	3 yrs = 15.9% 4 yrs = 7.95% 5 yrs = 0%

<sup>1</sup> Effective tax rate in table for QSBS issued before September 28, 2010, assumes gain realized for full \$10 million; gain of less than full cap results in a lower effective tax rate. If the applicable QSBS exclusion percentage is 50% or 75%, then the portion of eligible gain that remains subject to tax (i.e., 50% or 25%, respectively) is taxed at a blended rate of 31.8% (i.e., a special 28% federal income tax rate under the QSBS rules (IRC Section 1(h)(4)), plus the 3.8% net investment income tax rate). The Effective Tax Rate in the foregoing table is based on ratio of the special rate as a percentage of total gain (up to the exclusion cap) from the sale or exchange of QSBS. Gain realized in excess of the maximum gain eligible for exclusion is subject to a 20% long-term capital gain rate and additional net investment income tax of 3.8%. For QSBS issued before September 28, 2010, 7% of any excluded gain is an AMT preference item, which could trigger AMT (IRC Section 57(7)). Consult your tax advisor to confirm your situation.

## Other key information

- **1045 Rollover:** Under §1045, if QSBS is sold before the required holding period but after holding the shares for at least six months, a taxpayer may defer the gain by rolling the proceeds into replacement QSBS within 60 days of the sale. The holding period on the new QSBS continues to count from the acquisition date of the original QSBS.
- **State income taxes:** Some states like California and Pennsylvania do not provide any QSBS exclusion or §1045 deferral for state income tax purposes. Consult your tax professional to confirm your situation. Residency planning or gifting to trusts subject to the laws of a no-tax state like Nevada, Delaware or South Dakota can help reduce state income tax.
- **Beware of Disqualification.** QSBS can be disqualified in numerous ways, including: redemptions of more than 5% of the company's stock or more than 2% of a single shareholder within a two-year period; changing from a C-corp to an LLC or S-corp; stock buybacks during the two year window around stock issuance; if the company holds more than 20% of its assets in stocks, bonds or other investments; improper documentation. Consult your tax professional for guidance.

## Conclusion

QSBS remains a powerful option available to founders and investors alike for helping to build and harvest wealth in a tax-efficient manner. The enhancements associated with OBBBA opens up new opportunity - but also the complexity. Proper planning, careful documentation, and proactive coordination with advisors are essential.

For owners of QSBS, the key takeaway is simple: understand which “rule set” applies to your shares, obtain documentation confirming QSBS status, align exit strategies with the applicable holding period, and leverage the expanded opportunities created by OBBBA.

Contact your Wells Fargo advisor for more information and consult your tax professional to discuss potential QSBS benefits in your situation.

Source: Internal Revenue Code (IRC) Section 1202, as amended by the *One Big Beautiful Bill Act*, Pub. L. No. 119-21, H.R. 1, 119th Cong. (2025), passed on July 4, 2025; IRC Section 1(h)(4); IRC Section 57(7); IRC Section 1045.

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