

Income Insights: Sale of Qualified Small Business Stock

Income Insights is a series designed to quickly describe important income tax concepts for advisors and their clients.

Authors	Date	Topic
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Sale of Qualified Small Business Stock

To encourage investment in U.S. small businesses and startups, Congress enacted Section 1202 of the Internal Revenue Code (IRC). Under this section, investors in Qualified Small Business Stock (QSBS) who meet the requirements can receive significant tax benefits.

Taxpayers who have held stock in a qualified small business (QSB) *for a certain period of time* may be eligible to exclude all or a portion of the gain associated with that stock. For purposes of Section 1202, a QSB is a business that meets these criteria:

- The company must be taxed as a domestic C corporation.
- For stock issued before July 4, 2025, the company's aggregate gross assets must not exceed \$50 million before and immediately after the stock issuance.
- For stock issued on or after July 4, 2025, the company's aggregate gross assets must not exceed \$75 million—to be adjusted annually for inflation—before and immediately after the stock issuance.
- The company must be engaged in a qualifying trade or business, and 80% of the company's assets must be used in actively conducting one or more qualifying trades or businesses.

Per the IRC, a qualifying trade or business does *not* include businesses primarily engaged in performing services in certain fields, including health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business in which the principal asset is the reputation or skill of one or more of its employees. The definition of a qualifying trade or business also excludes any banking, insurance, financing, leasing, investing, or farming businesses and any hotel, motel, or restaurant.

Investors who sell QSBS and meet the holding period requirement can exclude a significant portion of their capital gains from federal tax when that stock is sold. For stock acquired before July 4, 2025, the exclusion applies only for stock held for five years or more and is first limited to the greater of \$10 million in gains or 10 times the adjusted basis of the stock sold. The percentage of gain that can be excluded then depends on when the stock was acquired:

- Stock acquired between August 11, 1993, and February 18, 2009, is eligible for a 50% exclusion.
- Stock acquired between February 19, 2009, and September 27, 2010, is eligible for a 75% exclusion.

- Stock acquired on or after September 28, 2010, is eligible for a 100% exclusion.

For stock acquired on or after July 4, 2025, the exclusion is first limited to the greater of \$15 million—to be adjusted annually for inflation—in gains or 10 times the adjusted basis of the stock sold. The percentage of the gain that can be excluded then depends on how long the stock was held:

- Stock held for more than three years but less than four is eligible for a 50% gain exclusion.
- Stock held for more than four years but less than five is eligible for a 75% gain exclusion.
- Stock held for five years or more is eligible for a 100% capital gain exclusion.

Taxpayers who are ineligible for Section 1202's capital gain exclusion solely because they don't meet the five-year holding period requirement may be able to defer that gain-recognition event by using [Section 1045](#), which provides tax benefits for rolling over proceeds from the sale of QSBS to purchase replacement QSBS.

In order to obtain the tax benefit under Section 1202, the taxpayer must report the gain and exclusion on Schedule D and Form 8949 of their income tax return for the tax year in which the QSBS is sold.

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