



# A Quick Guide to Understanding the QSBS Tax Exemption



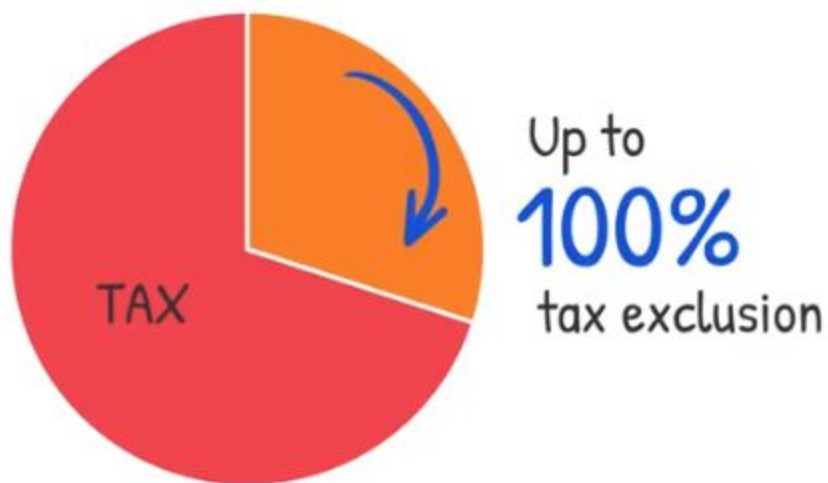
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**Qualified Small Business Stock (QSBS) provides for up to a 100% exclusion of Capital Gains taxes.** The QSBS regulations are located in Internal Revenue Code (IRC) Section 1202 and include criteria for both the corporation to qualify as a Qualified Small Business and criteria for the investor to determine how much of their gain may be eligible for tax exclusion.

QSBS Expert is here to help you understand Qualified Small Business Stock and connect you to the rights resource., whether you:

1. Already hold stock and are wondering if it is QSBS eligible, or
2. Are looking to start or invest in a Company and want to make sure you maximize QSBS eligibility.
3. Have a QSBS gain that you're looking to rollover.



## Why am I hearing so much about QSBS now?

The Small Business Jobs Act of 2010 (“2010 SBJA”) amended Section 1202 to permit the exclusion of 100% of capital gains for QSBS. Prior to then the exemption level was set at 75% and prior to then 50%. The PATH act of 2015 made the 100% exclusion permanent.

At levels less than 100%, investors were finding the efforts involved with QSBS to not be worthwhile as the effective tax savings was relatively small.

Given the 5 year holding period requirement coupled with the 100% exclusion becoming permanent in 2015, many more QSBS situations were first being realized in 2020, making QSBS relevant to many.



# Understanding the QSBS Tax Exemption

In order to qualify as QSBS, first **the Company needs to qualify:**

Was the corporation's stock issued by a Domestic C Corporation?

Does the corporation pass the "Gross Assets Test"?

Does the corporation operate within a Qualified Industry?

Does the corporation pass the Active Trade or Business Test?



The issuer must be a C corporation in the U.S. (it can't be an S corporation).

The corporation's assets must be \$50 million or less at all times after August 9, 1993 (or the period of the company's existence) before and after the issuance of the stock.

The corporation must be in a business other than one involving personal services; banking, insurance, financing, leasing, or investing; farming; mining; or operating a hotel, motel, or restaurant. Essentially, then, permissible businesses include manufacturing, retailing, technology, and wholesaling.

The corporation must be an active business (not a holding company) at all times that the stock is held.



Then there are specific requirements regarding **the holder of the QSBS:**

Is the investor eligible to benefit from QSBS savings and how was the QSBS acquired?

Has the QSBS been held for at least 5 years?



The stock must be acquired in exchange for money or property or as pay for services provided to the corporation. Someone who acquires QSBS from another person usually cannot take advantage of the tax break for gain on the sale of the stock.



The stock must be held for 5-years in order to qualify for Section 1202 QSBS exemption.



If the stock qualifies for QSBS capital gains exemption, **how much of your gain is excluded?**

What is the applicable QSBS exemptions percentage?

Is all of my gain below the exemption limits?



Stock acquired after September 27, 2010:

- 100% exemption, free from income tax, alternative minimum tax, and the 3.8% net investment income tax.

Stock acquired between February 18, 2009, and September 27, 2010:

- 75% of the gain is excludable from gross income. Also, 7% of the gain is subject to the alternative minimum tax.

Stock acquired before February 18, 2009:

- The exclusion of gain is limited to 50%, and 7% of the gain is subject to the alternative minimum tax.

The excludable gain is limited to the greater of \$10 million or 10 times the adjusted basis of the investment.



## What if...

Your otherwise eligible QSBS was sold before meeting the 5-year holding period?



You can roll your QSBS over within 60 days of realizing your gain, pursuant to IRC Section 1045.

You incur a capital loss?



Qualifying capital losses may be able to be deducted against ordinary income, pursuant to IRC Section 1244.



## Grey Area

There is a lot of “grey area” with QSBS, making it unclear in many situations if the holdings ultimately qualify for exemption.

**We converted from an LLC to a C-Corp. Does that impact QSBS?**

**I hold options, convertible/ notes, SAFE, warrants, etc. When does my QSBS timeline start?**

**I sold my company for cash and stock in the new company. Does my gain qualify?**



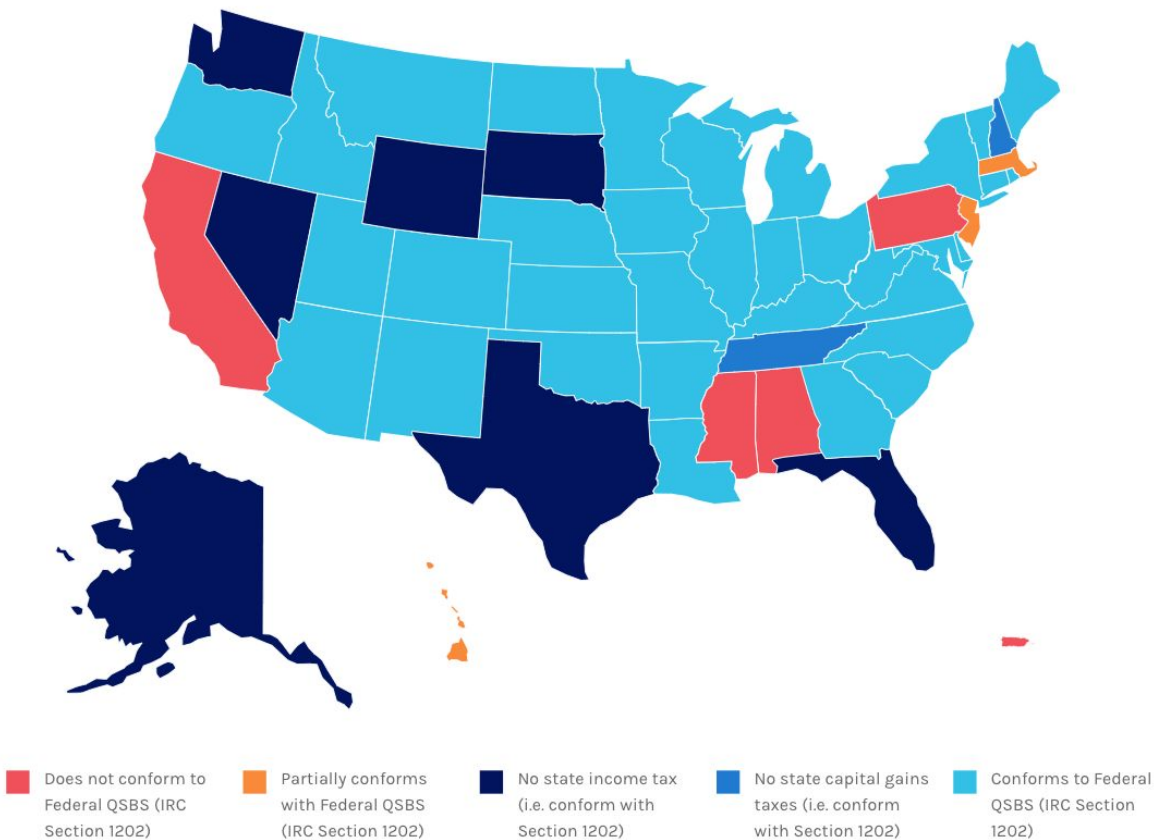


## How does my state treat QSBS?

While Section 1202 provides an exemption at the Federal level, not every state conforms to the Federal QSBS standards.

Visit our [QSBS for States](#) page to learn:

- Does my state conform to federal QSBS exclusions?
- How else does my state support entrepreneurship?
- Are the laws changing in my state?



## Key considerations for different QSBS stakeholders.

QSBS has implications for different stakeholders. Explore the nuances.



Individual  
Investor



Investment  
Fund



Founder



Employee



Service  
Provider





## Individual Investor

### 5 QSBS considerations as an individual investor:

1. How do I have assurance that the investment target company qualifies for QSBS?
2. How can I maintain my QSBS timeline with a Section 1045 rollover?  
In addition, what if I have a contingent consideration?
3. I recently purchased stock from an employee leaving the investment target company. Does my stock qualify for QSBS?
4. I am invested in a SPV and/or private equity fund does my investment still qualify for QSBS?
5. Can I transfer my QSBS to a relative or trust?



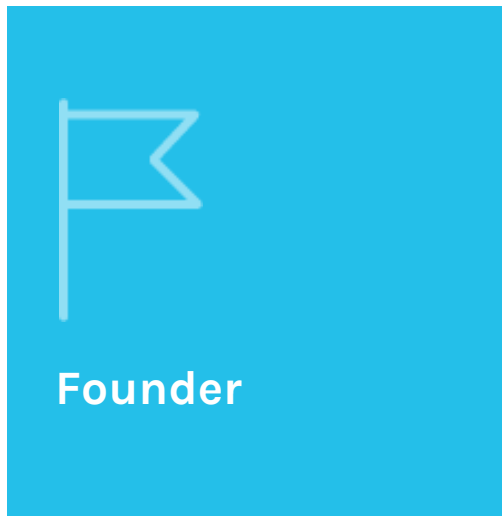


## Investment Fund

### 5 QSBS considerations as an investment fund manager:

1. Should I only invest in QSBS eligible companies?
2. What representations and covenants are other investors requiring their portfolio companies to make?
3. What is the best way to report QSBS gains and rollover opportunities to LPs?
4. Does carried interest qualify for the Section 1202 tax exclusion?
5. Can carried interest be rolled over with Section 1045?





## 5 QSBS considerations as a founder:

1. Can I switch my company to a C Corp and still qualify?
2. Our company recently had a tax-free merger does my new stock qualify?
3. We redeemed an ex-founder's shares. Does that affect my QSBS?
4. How can we structure an employee stock incentive to maximize QSBS savings?
5. I have founder shares and contributed property. Do they both qualify for QSBS?





## Employee

### 5 QSBS considerations as an employee:

1. Should I elect the Section 83(b) election for my stock options?
2. When does my QSBS timeline start with my vesting stock options?
3. I exercised and sold my stock. How do I report QSBS gains on my taxes?
4. Can I sell my shares back to the company and still qualify for QSBS?
5. What is my QSBS basis when calculating my excludable gain?





**Service  
Provider**

## 5 QSBS considerations as a service provider:

1. Are there nuances in the type of client I am representing with respect to QSBS?
2. Where can I find QSBS eligible Section 1045 rollovers for my client?
3. My client recently got into a divorce how does this affect their QSBS?
4. What rate is my client's gain taxed at if the exclusion does not cover the full gain?
5. How can I help my client structure their transaction to maximize QSBS tax savings?





## Need more information about QSBS?

### Stay up to date on all things QSBS

[Click here to sign up to receive our newsletter.](#)

### Have a specific question regarding a QSBS situation you are working through or planning for?

We can help you:

- Analyze and document your QSBS situation
- Provide your investors or employees with information regarding QSBS gains
- Identify new QSBS and Section 1045 rollover opportunities

[Click here to fill out our form and we will get you help.](#)

