

Estate Planning with Qualified Small Business Stock (QSBS)

The new tax law enhances the benefits

Qualified Small Business Stock (QSBS) can be a powerful tax and estate planning tool, enabling eligible business owners — and their heirs — to exclude up to 100% of the capital gain when they sell their stock. The One Big Beautiful Bill Act (OBBBA) enhances the benefits of QSBS by shortening holding periods (for partial exclusions), increasing exclusion limits and expanding the number of businesses that qualify.

How does QSBS work?

Internal Revenue Code Section 1202 allows individuals and other noncorporate taxpayers (including U.S. trusts and estates) to exclude from federal taxable income up to 100% of eligible capital gains on the sale of stock in a C corporation that meets the definition of a “qualified small business.” In addition to satisfying a gross assets test (discussed below), eligible businesses must be “active,” meaning they use at least 80% of their assets (by value) in one or more qualified active trades or businesses and no more than 10% of their assets consist of nonbusiness real estate. Certain business types are excluded, including professional services, finance, farming, mineral production and hospitality.

To qualify for the 100% exclusion, a shareholder must:

Acquire the stock as part of an original issuance. This means the stock must be acquired directly from the corporation (or an underwriter) rather than from another shareholder — in exchange for money, property (other than stock), or services, and

Hold the stock for at least five years after it’s issued. For estate planning purposes, there’s an exception to the original issuance requirement for stock received by gift or inheritance, and the transferor’s holding period is tacked on to the recipients for purposes of the five-year requirement.

What’s changed?

The OBBBA made three key changes to the QSBS framework:

1. Shorter holding periods. Although taxpayers are still required to hold QSBS for at least five years to enjoy the 100% exclusion, they’re now eligible for partial exclusions for stock held for shorter periods. For QSBS acquired after July 4, 2025, taxpayers may exclude:

- Up to 50% of the capital gain on stock held for at least three years, or
- Up to 75% of the capital gain on stock held for at least four years.

Note that the taxable portion of capital gain eligible for the 50% or 75% exclusion is taxed at a 28% rate. In other words, gain eligible for the 50% exclusion is taxed at a 14% effective rate and gain eligible for the 75% exclusion is taxed at a 7% effective rate. The taxable gain may also be subject to the 3.8% net investment income tax.

2. Higher exclusion limit. Previously, there was a lifetime cap on the amount of gain that could be excluded on the sale of a particular issuer's stock equal to the greater of \$10 million or 10 times the taxpayer's adjusted basis in the QSBS being sold. The OBBBA increased this "per-issuer" cap to the greater of \$15 million (indexed for inflation after 2026) or 10 times the adjusted basis, for QSBS acquired after July 4, 2025.

3. Increased asset threshold for qualified small businesses. Previously, a qualified small business for QSBS purposes was one whose aggregate gross assets (including the assets of a more-than-50%-owned subsidiary) didn't exceed \$50 million at any time after Aug. 10, 1993, or immediately after the stock was issued. The OBBBA increased this threshold to \$75 million (indexed for inflation after 2026).

What are the estate planning benefits?

By allowing shorter holding periods for partial exclusions and increasing the per-issuer cap and asset threshold, the OBBBA expands estate planning opportunities for owners of C corporations. Ordinarily, gifting stock to your heirs removes future appreciation from your taxable estate but creates a significant potential capital gains tax liability for the recipient, who inherits your tax basis rather than the stepped-up basis enjoyed by assets transferred at death. Gifting QSBS makes it possible to remove future appreciation from your estate while preserving tax-free gains for your recipient.

Attractive opportunities, but is it right for you?

QSBS offers extraordinary tax and estate planning opportunities, and the benefits are even more attractive under the OBBBA. Bear in mind that these opportunities aren't right for everyone. Talk to your professional tax and estate planning advisors for additional details.

Sidebar: QSBS "stacking" multiplies the tax benefits

It's possible to amplify the tax benefits of qualified small business stock (QSBS) through a strategy known as "stacking." As noted in the main article, these benefits are available to individuals who receive stock as a gift or by inheritance. By gifting QSBS to one or more family members — either directly or through a carefully designed irrevocable nongrantor trust — you can enable each recipient to exclude up to \$15 million in capital gain for federal tax purposes.

Suppose, for example, that Robert starts a technology company, organized as a C corporation, on Jan. 1, 2026, with an investment of \$200,000 in exchange for 1 million shares of the company's stock. By Jan. 1, 2031, the company is worth \$30 million. If Robert sells the company, he'll be entitled to exclude \$15 million of capital gain (assuming his basis is equal to the original \$200,000 investment) leaving nearly \$15 million in taxable gain. If, instead, Robert gifted half of his stock to an irrevocable nongrantor trust for the benefit of his daughter before selling the company, both he and the trust could each claim a \$15 million exclusion, allowing them to sell the company tax-free.