Section 1045 Planning for Installment Sales, Earnouts, and Noncash Consideration

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I. Introduction

Section 1045 permits taxpayers to defer gain from the sale of qualified small business stock (QSBS) by reinvesting sales proceeds into replacement QSBS within the 60-day period beginning on the "date of such sale."[1] Section 1045 not only allows taxpayers to elect to exclude realized capital gains from income tax and permits the tacking of the holding periods of the taxpayer's original and replacement QSBS investments, but also keeps the hope alive that the deferred gain will ultimately be excluded entirely under section 1202 when the replacement QSBS is sold. The statute represents a significant planning opportunity for taxpayers who are fortunate enough to sell QSBS before satisfying section 1202's holding period requirement or before their aggregate sales proceeds exceed section 1202's gain exclusion cap.

Section 1045's 60-day window is straightforward when 100 percent of the consideration for the original QSBS is paid in cash at closing. But modern mergers and acquisitions transactions routinely involve in-kind payments of buyer equity subject to contractual lockups or regulatory resale restrictions and postclosing purchase price adjustments, such as working capital holdbacks, indemnity escrows, installment payments, and earnouts tied to postclosing performance. In these transactions, a substantial portion of the total consideration may not be received until months or years after the stock sale closed and therefore arguably well outside the 60-day window. When that occurs, section 1045's rollover requirement creates two distinct analytical problems that this article addresses.

The first is a question of what qualifies as a purchase of replacement QSBS. Section 1045 requires that replacement QSBS be purchased within the 60-day period, but neither the code nor Treasury regulations specify that the purchase consideration must be cash. This article examines whether, and on what authority,

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replacement QSBS can be acquired using noncash consideration, including the contribution of contract rights to deferred purchase consideration or a taxpayer-issued promissory note, as a means of satisfying the rollover requirement within 60 days of closing without waiting for actual cash receipts.

The second is a question of when the 60-day clock starts. Section 1045's reference to the "60-day period beginning on the date of such sale" does not address what constitutes the "date of sale" when consideration is payable in installments governed by section 453. Under the most conservative reading, the clock runs from the date title to the original QSBS is transferred, regardless of when payment is actually received. This article examines whether a more taxpayer-favorable interpretation — that the 60-day period commences upon the recognition of each installment of capital gain — is supported by existing authority, including reg. section 1.1045-1(h)(1) and the qualified Opportunity Zone installment sale regulations under section 1400Z-2. The article also considers each strategy's practical implications, including the significant state income tax consequences for taxpayers in states such as California that do not conform to section 1202's gain exclusion, and concludes with a framework for choosing between available approaches based on a taxpayer's facts and risk tolerance.

II. Section 1045's Short 60-Day Window for Acquiring Replacement QSBS

Section 1045 provides that for QSBS held by a taxpayer for more than six months, a taxpayer recognizes gain only to the extent that "the amount realized on such sale exceeds — (1) the cost of any qualified small business stock *purchased by the taxpayer during the 60-day period beginning on the date of such sale*" (emphasis added). Reinvesting cash proceeds within the 60-day window under section 1045 can be challenging because of the tight time constraints. More difficult still is planning around situations involving sale transactions with deferred purchase consideration arrangements. For example, a taxpayer might sell QSBS, with the purchase consideration consisting of a modest up-front cash payment, working capital and indemnity escrows, deferred

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purchase consideration installments, and one or more earnout payments spanning multiple years after closing.[2] The mix of purchase consideration often also includes taxable in-kind payments in the form of buyer equity, the immediate sale of which may be contractually restricted, subject to Rule 144[3] resale limitations, or simply unmarketable, effectively pushing any liquidity event outside of the 60-day postclosing period for rolling over proceeds under section 1045.

The combination of section 1045's short rollover window and the ubiquitous nature of deferred purchase consideration in M&A transactions can trigger several problems. When the deferred purchase consideration is a meaningful portion of a taxpayer's sales proceeds, finding money to roll over into replacement QSBS during the 60-day period may be difficult or in some cases simply impossible. Additionally, taxpayers may be reluctant to reinvest sales proceeds that may never materialize, such as, for example, contingent earnout payments or the release of indemnity escrow funds. Also, the process for properly reporting section 1045 rollovers of deferred payment installments on the year-of-sale tax return can be problematic.

This article addresses how to interpret section 1045's 60-day requirement and whether there are ways to navigate through the rule that solve taxpayers' practical funding problems and clear up the return reporting issues.

A. Immediate Rollover Into Replacement QSBS

The conservative approach would be to make a cash investment of 100 percent of the amount the taxpayer desires to roll over into replacement QSBS within the 60-day period after closing of the sale of the taxpayer's original QSBS investment. If any portion of the purchase consideration is not paid at closing, the taxpayer would still make a cash payment for that deferred amount within the 60-day period after closing using cash from other sources. Unlike section 1031's rules applicable to deferred like-kind exchanges, section 1045 does not require that the exact cash proceeds from the sale of the original QSBS be the same funds used to purchase replacement QSBS. Therefore, the taxpayer may use other available

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funds to complete the rollover within the required time frame.

Assuming the original stock was, in fact, QSBS held for at least six months, the applicable amount was invested into replacement QSBS within 60 days after closing, a section 1045 election was properly made on the tax return for the year of sale, and the taxpayer elected out of installment sale treatment, thereby accelerating and reporting the full amount of the excluded capital gains on the year-of-sale return, there should be little for the IRS or Tax Court to question or dispute, at least for the initial rollover.

As discussed further below, because the section 1045 election involves electing out of the payment of tax on capital gains reported on the taxpayer's income tax return, the taxpayer would presumably elect out of installment sale treatment or trigger a deemed transfer of an installment instrument under section 453B. Either would bring the entire deferred capital gain onto the taxpayer's return for the year of the original QSBS sale and thereby allow for the making of a section 1045 election for that gain. For example, if the taxpayer sells his original QSBS for $1 million (assume zero tax basis), with 100 percent of the purchase consideration payable 12 months after closing, the taxpayer would roll $1 million into replacement QSBS within the 60-day postclosing window using available cash from other sources, elect out of installment sale treatment for the $1 million deferred purchase consideration amount, report the $1 million of capital gain on his tax return for the year of sale, and make a section 1045 election for the $1 million of capital gains reported on his return for the sale of the original QSBS investment.

B. Substantiating Compliance With Section 1045's Rollover Requirements

Regardless of whether the purchase of replacement QSBS under section 1045 is funded with cash or "other property" (as discussed below), it's important to fully document the rollover and maintain adequate records. Taxpayers should maintain in their "QSBS File" evidence that the rollover QSBS was subscribed and paid for, and the replacement QSBS issued, during the applicable 60-day period.

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To be eligible to make a section 1045 election for capital gain arising out of the sale of stock, the taxpayer must be able to substantiate not only that the rollover equity was purchased and issued within the applicable 60-day period, but also that the original stock was QSBS when sold and that the corporation issuing the replacement QSBS actively conducted qualified business activities for at least the six-month period after issuance of the replacement QSBS.[4]

C. What if a Taxpayer Can't Fund a 100 Percent Cash Rollover?

Suppose the taxpayer doesn't have cash from other sources to bridge the gap between the cash received at closing and the deferred purchase consideration that may be paid later. What are the planning options if investing cash into replacement QSBS within the 60-day window creates cash flow problems, or if the taxpayer simply does not want to commit funds for a rollover of purchase consideration that's contingent and may never be earned? In this situation, the taxpayer's ability to reinvest is strictly limited to the cash proceeds actually received at closing, making it impossible to roll over the deferred amounts unless alternative planning strategies are available. Identifying possible planning options first requires answering several key questions. What about purchasing replacement QSBS with in-kind purchase consideration or taxpayer's debt instruments? Are there arguments that the 60-day period should run from the installment payment date(s)? These issues are discussed below.

III. Stepping Back and Examining the Language of Section 1045

At first glance, taxpayers might interpret section 1045 as clearly mandating a cash investment in replacement stock within 60 days of selling their original QSBS. However, does a deeper examination of the statutory language actually support this assumption?

Neither section 1045 nor the Treasury regulations promulgated thereunder mention the purchase of rollover QSBS for money, or for

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that matter, address what would qualify as permissible consideration for the purchase of replacement QSBS. What section 1045 expressly refers to is QSBS "purchased" during the 60-day period beginning on the "date of sale" of a taxpayer's original QSBS. What exactly does the statute mean by the reference to a purchase of QSBS? And what exactly does the statute mean by the reference to date of sale of QSBS?

A. The Meaning of Section 1045's Reference to the 'Purchase' of Replacement QSBS

The term "purchase" is not fully defined in sections 1202 or 1045, or in tax authorities interpreting those statutes. A review of the applicable tax authorities confirms that there is no universal definition of purchase for income tax purposes. Under the code, a purchase of stock involves an acquisition for cost where the purchaser's tax basis in the acquired property equals the purchase consideration paid for the stock, plus any other costs associated with the acquisition. Section 1045(b)(2) provides that "a taxpayer shall be treated as having purchased any property if, but for paragraph (3), the unadjusted basis of such property in the hands of the taxpayer would be its cost (within the meaning of section 1012)." So, at the 50,000-foot level, purchase means a taxable acquisition of property for cost as contrasted with a nontaxable transfer or exchange, except perhaps for a section 351 nonrecognition exchange involving the exchange of property with a fair market value tax basis for stock.[5] Section 1012 provides that in connection with the purchase of stock, the purchaser's tax basis is the stock's cost. Reg. section 1.1012-1(a) provides that the basis of property is its cost and that cost is the amount paid for the property in cash or other property. Reg. section 1.1012-1(g) further provides that if a debt instrument is exchanged for property, the cost of the property attributable to the debt instrument is the issue price of the debt instrument. Section 1012 provides express support for the position that purchase consideration for stock can consist of money, other property, and purchaser debt instruments.

Beyond section 1012, other provisions of the code support the conclusion reached by reading section 1012. Section 355(d)(5)(A)

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defines and limits the term “purchase” to:

any acquisition [of stock] but only if — (i) the basis of the property acquired in the hands of the acquiror is not determined (I) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or (II) under section 1014(a), and (ii) the property is not acquired in an exchange to which section 351, 354, 355, or 356 applies.

Section 338(h)(3)(A) provides that purchase means any acquisition of stock, but only if all the following conditions are satisfied:

(i) the basis of the stock in the hands of the purchasing corporation is not determined (I) in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom acquired, or (II) under section 1014(a) (relating to property acquired from a decedent), (ii) the stock is not acquired in an exchange to which section 351, 354, 355, or 356 applies and is not acquired in any other transaction described in regulations in which the transferor does not recognize the entire amount of the gain or loss realized on the transaction, and (iii) the stock is not acquired from a person the ownership of whose stock would, under section 318(a) (other than paragraph (4) thereof), be attributed to the person acquiring such stock.

While section 1032 doesn’t use the term “purchase,” the statute does confirm that there is no gain or loss to a corporation in connection with the exchange of property triggered by the receipt of money or other property in exchange for stock. Reg. section 1.1032-1(a) refers to the sale by a corporation of its own shares for money or other property.

The consistent thread running throughout tax authorities is that a purchase of stock is not limited to a purchase of stock for money. Instead, stock (including replacement QSBS under section 1045) can be purchased for money, other property, whether tangible or intangible, and purchaser debt instruments, all of which are includable in the cost of stock for federal income tax purposes.

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It should be noted that the definitions of purchase in sections 355(d)(5)(A) and 338(h)(3)(A) were crafted for specific antiavoidance purposes, and both provisions expressly exclude from the definition of purchase any acquisition in a transaction to which section 351 applies.[6] For purposes of the planning strategies discussed in this article, which involve a taxpayer subscribing for replacement QSBS with money, other property, or a debt instrument, the relevant inquiry is whether the consideration used to acquire replacement QSBS constitutes cost within the meaning of section 1012, which it does regardless of whether the acquisition is also characterized as a section 351 exchange.

In light of this broader scope of what constitutes acceptable purchase consideration, planning strategies for meeting section 1045's purchase requirement beyond making a cash payment within 60 days after the closing of a taxpayer's sale of QSBS are discussed below.

B. Strategies for Acquiring Replacement QSBS With 'Other Property'

Stepping back and looking at what might qualify as part of the cost for the purchase of replacement QSBS opens the door for several planning possibilities to address the cash flow issues or aggregate consideration uncertainties presented by the inclusion of deferred payments when a taxpayer's original QSBS is sold.

1. Use of a taxpayer debt instrument (promissory note).

One possible solution for taxpayers who cannot fund an immediate cash rollover is to acquire replacement QSBS from the issuing corporation in exchange for a taxpayer-issued debt instrument. Reg. section 1.1012-1(g) provides that if a debt instrument is exchanged for property, the cost of the property attributable to the debt instrument is the issue price of the debt instrument. Because section 1045's purchase requirement incorporates section 1012's cost standard, the issue price of a taxpayer promissory note can constitute part or all of the cost of replacement QSBS for purposes of section 1045. If the taxpayer acquires replacement QSBS within

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60 days of the sale of the original QSBS in exchange for a promissory note with an issue price equal to the amount of gain the taxpayer desires to defer, the taxpayer may have a reasonable basis for concluding that the purchase requirement is satisfied without deploying cash before deferred sale proceeds are actually received.

There is no direct IRS or Tax Court authority addressing the use of a taxpayer promissory note as consideration for the acquisition of replacement QSBS under section 1045. The primary body of applicable guidance involves an employee's acquisition of employer stock with a recourse promissory note.[7] Although that context is different, the structuring principles it establishes provide reasonable analogical support if followed carefully. Taxpayers pursuing this strategy should satisfy the following structuring requirements to give the arrangement its strongest footing:

- **Recourse obligation.** The note must be a genuine recourse obligation for which the taxpayer bears personal liability for repayment regardless of the value of the replacement QSBS received. A nonrecourse note repayable only from the value of the stock itself may not constitute genuine cost for section 1012 purposes because the IRS could characterize the arrangement as a contingent acquisition rather than a purchase, potentially defeating the purchase requirement entirely.
- **Commercially reasonable terms and adequate stated interest.** The note must carry interest at a rate at or above the applicable federal rate for its term. Under section 1274, a debt instrument issued in exchange for property with inadequate stated interest is subject to original issue discount rules, and the issue price — and therefore the section 1012 cost — will be the imputed principal amount determined under section 1274, not the face amount of the note. A below-market note would therefore reduce the cost of the replacement QSBS below its intended face value, potentially undermining the full amount of gain deferral the taxpayer seeks.
- **Payment history.** The arrangement must be performed strictly in accordance with its terms. A promissory note

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arrangement that exists only on paper in which payments are never actually made or are routinely deferred informally risks recharacterization by the IRS as a capital contribution (giving the taxpayer a zero cost basis in the replacement QSBS) or as a sham transaction lacking economic substance.

- **Earnout-linked payment schedule.** From a practical standpoint, structuring the note's principal repayment schedule to correspond to the taxpayer's anticipated receipt of deferred purchase consideration from the original QSBS sale can reduce the risk that the taxpayer will be unable to service the note. For example, if earnout payments are expected in years 2 and 3 after closing, the note could provide for principal repayment in corresponding amounts in those years. However, the note must be a genuine unconditional payment obligation, with earnout receipts serving as an anticipated source of funding, not as a condition of repayment. A note whose payment is expressly contingent on earnout receipts may not constitute a genuine debt instrument and could be recharacterized as a contingent purchase price arrangement, defeating the cost basis argument on which the entire strategy rests.

Taxpayers pursuing this strategy should also confirm that the replacement QSBS corporation is issuing stock in exchange for the note as an original issuance, satisfying section 1202(c)(1)(B)(i)'s requirement that QSBS be acquired "in exchange for money or other property (not including stock)." A taxpayer promissory note constitutes other property for this purpose and should satisfy the original issuance requirement. Because this is a planning position without direct precedent in the QSBS context, taxpayers should maintain thorough contemporaneous documentation of the note's terms, the commercial rationale for the arrangement, and evidence that all scheduled payments were made as required.

2. Contract rights associated with the deferred purchase consideration.

Given the tie-in between the cost of replacement QSBS and the amount of capital gain to be excluded under section 1045, there

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appears to be no reason why any form of other property cannot be exchanged for replacement QSBS, as long as the other property allows for the satisfaction of the requirement in section 1045(b)(2) that the unadjusted basis of the property in the hands of the taxpayer would be its cost within the meaning of section 1012. The basis of other property should be its cost for purposes of section 1012 where either the exchange of the property is taxable, triggering gain that increases the basis in the property to its FMV, or, if the transaction is structured as a nontaxable section 351 exchange, the tax basis of the property is equal to its FMV at the time of the exchange. This opens the door to acquiring replacement QSBS with other property (noncash assets), provided the section 1012 cost basis requirement of section 1045(b)(2) is satisfied.

Whether a noncash exchange results in replacement QSBS with a section 1012 cost basis depends on whether the exchange is taxable or nontaxable:

- If the exchange is taxable, meaning the taxpayer recognizes gain or loss on the contributed property, the taxpayer's basis in the replacement QSBS is determined by reference to the cost paid (that is, the FMV of the property exchanged, after any gain recognition step-up). This satisfies section 1045(b)(2) because the unadjusted basis equals the section 1012 cost.
- If the exchange is a section 351 nonrecognition exchange, a key practical limitation applies. Under section 358, the taxpayer's basis in the replacement QSBS is a carryover of the contributed property's basis, determined under subchapter C (not under section 1012). Section 1045(b)(2) asks whether the basis would be "cost (within the meaning of Section 1012)," and section 1012(a) expressly excepts subchapter C from its cost basis rule. Accordingly, a section 351 contribution of low-basis property in which the carryover basis is meaningfully less than FMV will generally not satisfy section 1045(b)(2). However, when the contributed property's basis already equals its FMV (so that carryover basis = FMV = what section 1012 cost would be), the practical result is indistinguishable from a cost basis acquisition, and section 1045(b)(2) should

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be satisfied on the merits. The following examples illustrate these principles.

Example 1 (taxable exchange). Gold coins with a tax basis of $1,000 and an FMV of $10,000 are exchanged in a taxable transaction for replacement QSBS. The gain on the coins ($9,000) is recognized, the taxpayer's basis in the coins steps up to $10,000 (their FMV), and the cost of the replacement QSBS equals $10,000. Section 1045(b)(2) is satisfied, and up to $10,000 of gain may be deferred under section 1045.

Example 2 (section 351 exchange in which basis = FMV). Gold coins with a tax basis *and* FMV of $10,000 are contributed in a section 351 nonrecognition exchange for replacement QSBS. The section 358 carryover basis of the replacement QSBS is $10,000, equal to what the section 1012 cost would be. Section 1045(b)(2) is satisfied.

Example 3 (section 351 exchange in which basis ≠ FMV). Gold coins with a tax basis of $1,000 and FMV of $10,000 are contributed in a section 351 nonrecognition exchange for replacement QSBS. The section 358 carryover basis of the replacement QSBS is $1,000, not $10,000. Because the unadjusted basis ($1,000) does not equal the section 1012 cost ($10,000), section 1045(b)(2) is not satisfied for the $9,000 difference, and the acquisition does not constitute a qualifying purchase of replacement QSBS to that extent.

a. Contribution of section 453 installment obligations as 'other property.'

A taxpayer who holds a section 453 installment obligation received as deferred purchase consideration from the sale of original QSBS may contribute that obligation to the replacement QSBS corporation in exchange for stock within the 60-day period following the sale. The FMV of the contributed obligation constitutes the cost of the replacement QSBS under reg. section 1.1012-1(a), satisfying section 1045(b)(2), provided the acquisition is treated as a taxable exchange.

Critically, because section 453B(a) provides that gain results whenever an installment obligation is "distributed, transmitted, sold, or otherwise disposed of," and because the recognized exceptions

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to section 453B(a) are limited (transmission at death and transfers between spouses), the contribution of an installment obligation to the replacement QSBS corporation constitutes a taxable disposition under section 453B(a)(2), triggering gain equal to the difference between the obligation's section 453B(b) basis and its FMV at the time of contribution. For a taxpayer with zero basis in the original QSBS, the section 453B(b) basis of the installment obligation is also zero, meaning the full FMV of the obligation constitutes recognized gain.

Importantly, section 453B(a) provides that this gain "shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received," making it eligible for a corresponding section 1045 election. The section 453B disposition also triggers the basis step-up that satisfies Example 1's qualifying exchange model above. The taxpayer's basis in the installment obligation steps up to FMV through the taxable exchange, and the replacement QSBS receives a section 1012 cost basis equal to that FMV.

b. Valuation

The FMV of the installment obligation at the time of contribution to the replacement QSBS corporation is the critical variable in this strategy, as it simultaneously determines: (1) the amount of section 453B gain triggered (and hence the capital gain eligible for the section 1045 election) and (2) the cost of the replacement QSBS for section 1045 purposes. The FMV of an installment obligation will typically be less than its face value, often significantly so, for contingent earnout obligations (whose value depends on future performance), long-dated obligations, or obligations owed by buyers with uncertain creditworthiness. Taxpayers should obtain a contemporaneous, defensible valuation before executing the strategy. If the obligation's FMV is materially below face value, the section 1045 deferral will be correspondingly limited, and the shortfall will remain subject to capital gains tax when installment payments are actually received. There is also no encouragement to undervalue the installment obligation because a lower valuation simply reduces the amount of gain eligible for the section 1045

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election.

c. Assignment restrictions and the 'payment rights' alternative.

When the QSBS sale agreement contains assignment restrictions that prohibit direct transfer of the installment obligation to the replacement QSBS corporation, the current draft suggests contributing "payment rights with respect to section 453 deferred installments" as an alternative. This alternative requires careful analysis before implementation.

If the payment rights being contributed are the installment obligation itself (that is, the actual contractual right to receive the deferred consideration), the analysis above applies, and section 453B(a) governs the disposition. However, if the taxpayer retains legal title to the installment obligation and instead contributes a derivative right to receive the cash flows generated by that obligation (effectively assigning the income stream while keeping the right to the underlying contract), the transaction implicates the assignment-of-income doctrine.[8] Under that doctrine, a taxpayer who directs anticipated income to a third party before receipt remains taxable on that income as if received, and the purported assignment to the replacement QSBS corporation may not be respected for income tax purposes. Additionally, a derivative income assignment that does not constitute a transfer of the installment obligation itself may not qualify as a disposition of an installment obligation under section 453B(a), potentially defeating the gain recognition event on which the section 1045 election depends. The payment rights alternative to direct contribution of the installment obligation should not be implemented without independent legal analysis addressing both the assignment-of-income doctrine and whether the arrangement constitutes a section 453B disposition.

d. Impact on the replacement QSBS issuer's section 1202 compliance.

A replacement QSBS corporation whose primary asset is a contributed installment obligation faces ongoing compliance risk under section 1202(e)(1)'s 80 percent active business test, which requires at least 80 percent of the corporation's assets by value to

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be used in the active conduct of a qualifying trade or business throughout substantially all of the taxpayer's holding period. An installment receivable is a passive financial asset, not an asset used in an active business, and would count against the 80 percent threshold.

Even if the installment note qualifies as a working capital investment asset, which is not free from doubt, the working capital exception provides only temporary and partial relief. Section 1202(e)(6)(B) treats investment assets as qualifying active conduct assets only if they are "reasonably expected to be used within 2 years to finance research and experimentation in a qualified trade or business or increases in working capital needs of a qualified trade or business." A multiyear installment note creates immediate tension with this requirement. In our view, only the portion of the note representing payments expected within the next two years can credibly satisfy the forward-looking deployment test.

More critically, section 1202(e)(6) imposes a hard 50 percent cap for corporations in existence for at least two years in that no more than half of total assets may qualify under the exception regardless of the corporation's deployment intent. When the contributed installment note constitutes the dominant balance sheet asset, this ceiling caps the corporation's qualifying assets at 50 percent, which is still 30 percentage points short of the 80 percent threshold. The exception does offer a cleaner path during the corporation's first two years of existence, when the 50 percent cap does not yet apply, and the full note value could potentially be shielded. But once that two-year window closes, the structural deficit is unavoidable absent rapid deployment of payments into qualifying active business assets and a corresponding buildup of operating assets that reduce the note's proportionate balance sheet weight below the 50 percent threshold. To that end, taxpayers must plan from the outset for how the replacement QSBS corporation will deploy the installment proceeds into qualifying active business assets once payments are received.

e. Risk calibration.

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The direct contribution of a section 453 installment obligation to the replacement QSBS corporation has a sound statutory foundation. Section 453B(a) is well established as governing the disposition, the character of gain is confirmed as capital gain from the QSBS sale, and the section 1012 cost basis framework of section 1045(b)(2) is satisfied through the taxable exchange. The principal risks are obtaining a defensible valuation of the obligation, ensuring compliance with the 80 percent test in section 1202, and confirming that any assignment restrictions in the sale agreement do not bar the contribution. The payment rights derivative assignment, by contrast, is a significantly more aggressive approach that carries meaningful risk under the assignment-of-income doctrine and lacks direct precedent in the QSBS context. It should not be pursued without a thorough independent legal analysis.

C. Electing Out of Installment Sale Treatment Under Section 453

Section 1045 is an election to roll over proceeds from the sale of original QSBS giving rise to capital gains reported on a shareholder's income tax return into replacement QSBS. An issue associated with the position that 100 percent of purchase consideration (both up-front and deferred) must be rolled over during the 60-day period after closing is the fact that the capital gain associated with the deferred payments will not be reported on the shareholder's income tax return for the year of sale unless a taxpayer elects out of installment sale treatment or there is a deemed disposition of the installment obligation.

The disconnect between when income is realized (in the year of sale) and recognized under section 453 (when the installment payments are made) and section 1045's 60-day rollover requirement suggests why both reg. section 1.1045-1(h)(1) and the Treasury regulations promulgated under section 1400Z-2 adopt the conclusion that section 1045's 60-day period should be tied to when capital gain from the sale of the original QSBS is recognized in the year of payment, rather than when title is transferred in the year of closing. Electing out of installment sale treatment seems to make sense whether the taxpayer makes an in-kind payment or uses a

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debt instrument to purchase replacement QSBS.

1. Election out of installment sale treatment.

Many deferred installments are structured as earnouts through which the actual proceeds can vary dramatically based on performance of the target company, the target's products, or the postacquisition performance of the combined buyer group. Section 453's regulations include detailed instructions addressing how to apply stock basis over a contingent payment stream.[9] If a taxpayer elects out of an installment obligation structured as a contingent earnout, the amount of income realized in the year of sale would be the FMV of the installment obligation. Presumably, the correct approach would be for the taxpayer to elect out of installment sale treatment, value the contract right to the deferred payment stream, treat that amount as capital gains on the tax return, and make a section 1045 election to roll that amount over into the replacement QSBS. Obviously, there would be no encouragement to undervalue the deferred installment obligation if the goal is to maximize the rollover of proceeds under section 1045.

If the aggregate earnout payments exceed the amount taken into income in the year of sale (and rolled over into replacement QSBS), those excess payments would generally be subject to CGT in the year of receipt. Conversely, if a taxpayer overvalues the earnout obligation and rolls over an amount into replacement QSBS that ultimately exceeds the actual earnout payments received, the taxpayer will have overinvested in replacement QSBS relative to the actual proceeds. While the section 1045 gain deferral would still apply to the amount actually rolled over, excess replacement QSBS basis (attributable to the overvalued earnout) will not give rise to a corresponding deferred gain to exclude or defer, potentially creating basis recovery complexity when the replacement QSBS is sold.

2. Reconciling the open transaction doctrine with the 60-day rollover requirement.

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The open transaction doctrine is a judicially created principle in U.S. income tax law[10] that allows a taxpayer to defer recognition of gain on a transaction when the value of property received is so speculative or uncertain that it cannot be reasonably ascertained at the time of the transaction. Reg. section 15A.453-1(d)(2)(iii) reflects the IRS's narrow view of open transaction treatment for contingent-payment sales. The sale of the QSBS of a pharma development company with purchase consideration structured to mimic a license arrangement for the company's pharma product would be one example in which the open transaction doctrine might apply. The rules of the open transaction doctrine are substituted for section 453's installment sale rules, and income is recognized when payments are received by the taxpayer.

A taxpayer choosing open transaction treatment over an FMV-based election out of section 453 should expect to bear a high evidentiary burden to demonstrate that the deferred payment right could not be valued with reasonable accuracy at closing. If a taxpayer's original QSBS is sold, and the purchase consideration is governed by the open transaction doctrine, recognition of payment would be open, but the timing of the sale of the original QSBS would not change. If a payment stream is subject to the open transaction doctrine, it would seem difficult, if not practically impossible, to meet a requirement that proceeds relating to the deferred payment stream be rolled over within a 60-day period after the original QSBS sale.

Regardless, a taxpayer's two alternatives are to treat the 60-day period as beginning when installment payments are made or to make a determination of the FMV of the open transaction contract rights and then either contribute the contract right or issue a corresponding debt instrument. Given the IRS's restrictive view of open transaction reporting, the FMV-based approach may be more defensible when a credible valuation can be obtained, while the payment-date approach should be reserved for situations when valuation uncertainty is truly exceptional and well-documented.

D. When Purchase Consideration Includes Taxable Issuance of Buyer Equity

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A taxpayer who receives as partial or full consideration a taxable payment in the form of buyer equity that cannot be immediately sold and turned into cash will experience the same liquidity issue plaguing taxpayers whose purchase consideration is substantially deferred. In many cases, the immediate sale of buyer equity is not practical because the equity is not marketable, or the equity is subject to contractual or regulatory resale restrictions. Buyer equity should be treated as other property for purposes of section 1012 if received in a taxable exchange, which should permit taxpayers to contribute the buyer equity (other than corporate stock) to a corporation in exchange for replacement QSBS.

Note, however, that the contribution of a minority interest in corporate stock will not work because section 1202(c)(1)(B)(i) provides that QSBS must be acquired at original issuance "in exchange for money or other property (not including stock)." Accordingly, a corporation cannot issue qualifying replacement QSBS in exchange for corporate stock contributed by the taxpayer. So, while corporate stock may be other property for purposes of section 1045, the use of the stock will trigger the failure to satisfy a key section 1202 eligibility requirement.

If the buyer equity is an interest in a partnership (limited partnership or limited liability company), the interest is other property that could potentially be contributed to the corporation for replacement QSBS. However, the LP or LLC interest is likely to be treated as a passive investment asset, not an asset "used in the active conduct" of a qualified trade or business for purposes of section 1202(e)(1)'s 80 percent test. Under section 1202(e)(1), at least 80 percent of the corporation's assets (by value) must be used in a qualifying active business. A contributed LP or LLC interest in an investment fund, private equity vehicle, or real estate entity would typically count as a passive asset, potentially causing the replacement QSBS corporation to fail the 80 percent threshold and lose its qualified small business status.

One possible plan would be for the taxpayer to contribute a right to payment when the stock is later sold, which should trigger the contractual right to receive the purchase consideration from the later sale of the buyer equity in exchange for the issuance of the

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replacement QSBS. If the taxpayer elects to assign a right to future income triggered by the sale of the buyer equity, the facts surrounding the assignment would need to be considered to determine what immediate tax consequences, if any, would be triggered by the assignment.

IV. What Is Meant by Section 1045's Reference to the 'Date of Sale' of QSBS?

The term "sale" is not defined in tax authorities interpreting sections 1202 or 1045. In connection with interpreting the meaning of sale generally for income tax purposes, the Supreme Court in *Iowa v. McFarland* stated that "a sale, in the ordinary sense of the word, is a transfer of property for a fixed price in money or its equivalent."[11] In *Williamson v. Berry*, the Court defined a sale as "a contract between parties to take and to pass rights of property for money, which the buyer pays or promises to pay to the seller for the thing bought and sold."[12] In general, tax authorities have concluded that a sale is deemed to have occurred and be closed for income tax purposes when title passes or at the time actual possession and the burdens and benefits of ownership are, from a practical standpoint, transferred to the buyer.[13]

In some factual situations, the question of whether a sale has occurred for purposes of section 1045 is beyond dispute. For example, if legal documents clearly show a transfer of title on a particular date in exchange for full FMV consideration paid in full in cash at closing, there appears to be no doubt that for purposes of section 1045, a sale has occurred, and the 60-day period for purchasing replacement QSBS runs from that sale date. But when the facts are more complicated, for example, when a stock sale closes in year 1 but some or all of the payments are made during later years, the determination of when the 60-day period commences for purchasing replacement QSBS under section 1045 is more complicated.

Section 1045 does not expressly address the issue of when the 60-day period commences if the taxpayer selling the original QSBS is paid in installments governed by section 453. A textualist reading of section 1045(a)(1), and likely the IRS's strongest argument, is that

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the date of sale means the date that title to the original QSBS changed hands, full stop. Under this reading, the installment sale rules of section 453 are merely an income recognition timing mechanism that does not alter when the underlying sale occurred, and the 60-day window runs from the closing date, regardless of when payment is actually received.

A court applying the plain-meaning canon would likely start from this position. But, as discussed below, there are tax authorities (including reg. section 1.1045-1(h)(1)) supporting the position that when payments are made on the installment basis, the date of sale should be tied to when capital gain is recognized and reported rather than when title transfers. Based on these authorities, the Tax Court might conclude that in connection with an installment sale transaction governed by section 453, the date of sale for purposes of the 60-day reinvestment period under section 1045 refers to the date capital gain from the sale of the original QSBS is reported on a taxpayer's return.

A. The Relevance of Reg. Section 1.1045-1(h)(1)

Section 1202 permits the purchase and sale of QSBS by a partnership (referred to as a "pass-thru" entity in the statute). If a partnership sells original QSBS, then both the partnership and its partners are eligible to elect section 1045 treatment. Income from the partnership's sale of stock when one or more payments are made in a year after the year of disposition would generally be reported by the partnership on the installment sale method under section 453. Under section 706, a partner would report the partnership's receipt of an installment payment governed by section 453 in the year of receipt of the installment payment, not in the year in which title to the original QSBS was transferred. Reg. section 1.1045-1(h)(1) provides that:

A partner making an election under section 1045 (as described under paragraph (c)(1) of this section) must do so on the partner's timely filed (including extension) Federal income tax return ***for the taxable year during which the partner's distributive share of the partnership's gain from***

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the sale of the QSB stock is taken into account by such partner under section 706. *[Emphasis added.]*

Section 706(a) in turn provides that:

In computing the taxable income of a partner for a taxable year, the inclusions required by section 702 and section 707(c) with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner.

Here, the section 1045 regulations appear to adopt the view that the year of sale for section 1045 purposes is tied to when the shareholder recognizes the capital gain from the sale of the original QSBS. To reach this result, Treasury must have concluded that section 1045's reference to date of sale is ambiguous regarding the timing of the 60-day period when there are deferred installments because the role of interpretive Treasury regulations is to interpret or implement code provisions, not make law. Reg. section 1.1045-1(h)(1) supports the taxpayer position that the concept of date of sale is ambiguous as used in section 1045 and that the regulation is a tax authority supporting the position that the 60-day period runs off of the reporting of capital gains from the sale of the original QSBS.

B. Opportunity Zone Regulations

A 180-day period for reinvesting capital gains was adopted by Congress under section 1400Z-2 in connection with the QOZ tax incentive program.[14] The QOZ program was enacted in 2017 to encourage investment in designated economically distressed communities through qualified opportunity funds. Generally, a QOZ program allows taxpayers to defer eligible capital gains realized during a tax year by reinvesting those gains in a QOF within the 180-day period beginning on the date that the eligible gain is realized. Section 1400Z-2 describes special rules applicable for capital gains invested in QOZs. The One Big Beautiful Bill Act[15] extended and modified the gain exclusion benefits. Congress clearly had in mind QSBS and section 1202's gain exclusion when drafting section

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1400Z-2, as section 1400Z-2(d)(2)(B)(ii) explicitly references section 1202(c)(3) in the context of redemptions.[16]

Section 1400Z-2(a)(1) provides that:

In the case of gain from the sale to, or exchange with, an unrelated person of any property held by the taxpayer, at the election of the taxpayer — (A) gross income for the taxable year shall not include so much of such gain as does not exceed the aggregate amount invested by the taxpayer in a qualified opportunity fund during the 180-day period beginning on the date of such sale or exchange.

The 180-day period for making an opportunity zone investment would seem at first glance to run from date of disposition of the capital asset. But the final QOZ regulations interpret the statute to provide that eligible gain includes gains that would be recognized by an eligible taxpayer under the installment method under section 453.[17] Reg. section 1.1400Z2(a)-1(b)(11)(viii)(B) provides that for gains reported on the installment method, taxpayers may treat each installment payment date or the last day of the taxable year in which the taxpayer would have recognized the gain under the installment method as the beginning of the 180-day reinvestment period.

Here again, the assumption must be that Treasury based the treatment of the 180-day period in the regulations on a determination that the wording of section 1400Z-2 was ambiguous, making it appropriate to interpret the statute to provide that the starting point for the 180-day reinvestment period in reg. section 1.1400Z2(a)-1(b)(11)(viii)(B) should run off the date the taxpayer was required to realize and report capital gains from the original stock investment. This approach further supports the argument discussed above regarding reg. section 1.1045-1(h)(1) that Treasury views statutory references to date of sale (whether for purposes of section 1400Z-2 or section 1045) to mean the date that sales proceeds are reported on a taxpayer's return rather than the date that stock title is transferred.

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It should be acknowledged, however, that the QOZ program was enacted in 2017 — well after the enactment of section 1045 in 1993. A skeptic might argue that Treasury's liberalization of the QOZ reinvestment period in the installment sale context reflects the policy goals of a newly enacted incentive program and does not necessarily signal how Treasury would interpret the older section 1045 language. Regardless, the structural parallel between the two provisions, both of which use "date of sale or exchange" as the trigger for a reinvestment window, provides meaningful analogical support, and Treasury's willingness to resolve the ambiguity in favor of taxpayers in the QOZ context is consistent with the pro-taxpayer interpretation of section 1045 advanced in this article.

C. Schedule D's Instructions

The instructions to Schedule D of Form 1040 provide guidance on how to report section 1202's gain exclusion for QSBS sold in an installment sale transaction under section 453. These instructions provide that if QSBS is sold in an installment sale, gain from the sale and the corresponding section 1202 gain exclusion is taken and reported with each applicable installment. Also, Schedule D's instructions under the section titled "Rollover of Gain From QSB Stock" state:

> If you sold QSB stock (defined earlier) that you held for more than 6 months, you can elect to postpone gain if you buy other QSB stock during the 60-day period that began on the date of the sale. . . . You must make the election no later than the due date (including extensions) for filing your tax return for the tax year in which the QSB stock was sold.

The Schedule D instructions do not expressly address how to treat or report an installment sale when there is a purchase of replacement stock under section 1045. The instructions are also not reconciled with reg. section 1.1045-1(h)(1), which ties the section 1045 election for partnership transactions to the year the gain is taken into account under section 706, a different standard than the instructions' general reference to the "tax year in which the QSB stock was sold." Taxpayers and tax professionals following the

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Schedule D instructions alone may not be aware of the regulatory requirement applicable to partnership dispositions, and the inconsistency underscores the need for updated IRS guidance.

IRS form instructions are not among the tax authorities listed in reg. section 1.6662-4(d)(3)(iii). The Tax Court has stated that "it is settled law that taxpayers cannot rely on [IRS] instructions to justify a reporting position otherwise inconsistent with controlling statutory provisions."[18] In the general overview of taxpayer reliance on guidance published in the Internal Revenue Bulletin and FAQs, the IRS noted that:

Informal guidance like forms, instructions, publications and IRS.gov webpages is another valuable alternative to guidance published in the Bulletin. . . . Informal guidance has not been published in the Bulletin and will not be relied on, used, or cited as precedents by Service personnel in the disposition of cases. If information included in informal guidance turns out to be an inaccurate statement of the law as applied to a particular taxpayer's case, the law will control the taxpayer's tax liability. Only guidance that is published in the Bulletin has precedential value.

V. Policy Reasons for the Short 60-Day Rollover Window and Related Musings

When considering how the Tax Court might approach interpreting section 1045's 60-day window, it might be helpful to step back and consider why Congress would include such a short rollover window. The drafters apparently made the choice to limit the benefits of section 1045 to taxpayers who promptly decided to purchase replacement QSBS. The code has several other time-based limitations on accessing various tax benefits. Two particular limitations that come to mind include the 30-day period for filing a section 83(b) election and the 180-day period for reinvesting capital gains into QOZ investments under section 1400Z-2. The legislative history associated with the adoption of these various short time limits on accessing benefits under the code, including section 1045's 60-day window, generally provides little explanation of the reasoning for the narrow time limits.

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Obviously, a short rollover window puts a burden on taxpayers to identify and close on suitable replacement QSBS investments within a 60-day window. A reasonable question is whether the drafters of section 1045 intended by the choice of language to require a taxpayer who sells QSBS for $1 million, 100 percent payable 24 months after the sale closing, to source $1 million in cash to fund purchasing replacement QSBS within 60 days after title to the taxpayer's original QSBS has transferred, or whether under those circumstances the reference to "date of sale" was intended to function as suggested in the section 1045 regulations (that is, when the date of sale is interpreted to mean when gain is recognized).

The distinction between the time limitation in section 83(b) and the 60-day limitation in section 1045 is twofold. First, section 83(b)'s 30-day window is a filing deadline, an election that the taxpayer either makes or misses, rather than a substantive transaction requirement tied to economic events. Second, and more importantly, section 83(b) is unambiguous in its operation and does not conflict with other code provisions. Section 1045's 60-day window, by contrast, is a substantive reinvestment requirement that directly conflicts with both section 453's installment sale income recognition rules and the partnership Schedule K-1 reporting framework, which Treasury resolved through regulation, confirming the ambiguity.

While the drafters of section 83 might acknowledge that it's unfair that founders who simply fail to file a section 83(b) election for restricted founder stock are later hit with a bucket of compensation income, they would likely conclude that the statute is unambiguous and operates as intended. In contrast with section 83, the functioning of section 1045's 60-day rule is not unambiguous. Treasury has addressed the ambiguity in the partnership-partner context with its guidance in reg. section 1.1045-1(h)(1). So, unlike section 83(b), the drafters of section 1045 might agree that while the reference to date of sale was intended to establish a short window for acquiring replacement QSBS, the language was not intended and should not be interpreted to create a conflict with both the tax treatment and business realities of deferred purchase consideration arrangements.

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VI. State Income Tax Issues and Nontax Considerations Deserve Attention

In connection with considering the planning options discussed in this article, taxpayers must carefully evaluate state income tax consequences before implementing any strategy that involves electing out of installment sale treatment under section 453(d). California residents face a particularly acute state tax problem. California does not conform to section 1202's gain exclusion, meaning its residents owe state income tax on all QSBS gain at ordinary income rates (currently up to 13.3 percent), regardless of any federal exclusion. When a California taxpayer elects out of installment sale treatment to make a section 1045 election, all deferred gain is accelerated onto the year-of-sale return triggering immediate California income tax on proceeds that may not be received for years. This can substantially change the economics of the rollover strategy, and for California residents the "wait for the installment payment date" argument (discussed above) may be significantly more attractive from a state tax perspective even if it carries greater federal tax uncertainty. Other states that do not conform to section 1202, including Alabama, Illinois, Mississippi, Pennsylvania, and Vermont, present similar issues. Taxpayers in those states should model the state tax cost of accelerating installment gain before electing out of section 453.

For taxpayers who elect out of installment sale treatment but do not intend to roll over 100 percent of the proceeds, the state tax cost of accelerating the non-rolled-over portion should be weighed against the simplicity of a clean election-out. The decision to reinvest original QSBS proceeds into replacement QSBS implicates significant investment and economic considerations beyond the federal tax benefits, and advisers should ensure clients understand the full cost-benefit picture before implementing any of the strategies discussed in this article.

Personal wealth and estate planning issues should also be taken into consideration during the planning process. Investment issues associated with rolling proceeds over into replacement QSBS should be considered. The question of whether a taxpayer will

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ultimately benefit from section 1202's gain exclusion for the replacement QSBS should also be factored into the planning process.

VII. Conclusions

The interaction between section 1045's 60-day rollover requirement and the deferred and noncash payment structures common in modern QSBS sale transactions raises two analytically distinct questions that existing tax authorities leave unresolved. The first is whether replacement QSBS can be purchased for purposes of section 1045 using consideration other than cash, including noncash property, contractual rights, or a taxpayer's promissory note. The second is whether the 60-day clock commences on the date title to the original QSBS transfers or, more favorably, on the date capital gain from the sale is recognized and reported on the taxpayer's return. Until a definitive authority resolves either question, taxpayers and their advisers must evaluate the available strategies based on their specific facts, tax profile, and risk tolerance. The following scenarios summarize the principal approaches discussed in this article.

Scenario 1: A meaningful portion of the consideration is deferred as fixed installment payments.

- **Conservative approach:** Advise the client to fund a cash rollover funded by other sources of the full desired rollover amount (including amounts attributable to deferred installments) within 60 days of closing and elect out of installment sale treatment under section 453 to accelerate all capital gains onto the year-of-sale return against which the section 1045 election is then made. This approach is cleanest from a documentation and audit standpoint, though it requires the client to have or borrow sufficient liquidity and may trigger adverse state income tax consequences (notably for California residents, who would accelerate a high state tax burden on the full deemed proceeds).
- **Promissory note approach:** If the client cannot fund a full cash rollover from other sources, advise structuring the

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purchase of replacement QSBS with a recourse promissory note on commercially reasonable terms, with principal payment obligations tied to the receipt of deferred installments from the original QSBS sale. The client should still elect out of installment sale treatment to bring all gain onto the year-of-sale return. This approach carries moderate risk in that there is no direct authority in the QSBS context but is supported by section 1012 and the employee stock note guidance and has the significant advantage of immediately starting the holding period tack under section 1202.

This article argues that replacement QSBS can be purchased within the meaning of section 1045 using noncash consideration, including a taxpayer recourse promissory note or the contribution of contract rights to receive deferred purchase consideration. The legal basis is that section 1012's broad definition of cost encompasses money, other property, and debt instruments, and section 1045's purchase requirement incorporates that standard. This approach allows a taxpayer to satisfy the 60-day window without deploying cash immediately by tying note principal payments or the value of contributed contractual rights to the eventual receipt of deferred consideration. Any contribution of contractual rights must be analyzed for potential disposition treatment under section 453B which, if triggered, would accelerate gain recognition and support a corresponding section 1045 election. There is no direct IRS guidance on the use of noncash consideration for this purpose, and the risk of IRS challenge is higher than under the conservative approach.

Scenario 2: A portion of consideration is contingent.

Earnouts present the most complexity. If the client elects out of installment sale treatment, the amount reportable in the year of sale for contingent earnouts is the FMV of the earnout obligation — not the maximum potential payout. Shareholders should work with a valuation professional to establish a defensible FMV for the earnout because there is no incentive to undervalue it (a higher value increases the amount eligible for the section 1045 rollover). The client rolls over that valued amount into replacement QSBS and makes the section 1045 election accordingly. Any earnout

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payments ultimately received exceeding the amount taken into income in the year of sale will generally be subject to CGT in the year of receipt.

If the earnout payments are so speculative that FMV cannot be reasonably determined (implicating the open transaction doctrine), the client faces a strong practical argument that the 60-day period should run from each payment date rather than the closing date. This is the highest-risk position and should be taken only with the benefit of a tax opinion and after careful consideration of the client's risk tolerance.

Scenario 3: A portion of consideration consists of buyer equity.

The taxpayer should determine whether the buyer equity is corporate stock or a noncorporate interest (an LP or an LLC). Corporate stock cannot be contributed as consideration for replacement QSBS without running afoul of section 1202's original issuance requirement. Partnership or LLC interests may be contributed as other property, but taxpayers should assess whether that asset will adversely affect the replacement corporation's ability to satisfy section 1202's ongoing 80 percent active business asset test. If neither approach is workable, the taxpayer may explore whether they can contribute the contractual right to receive proceeds from the future sale of the buyer equity.

The questions addressed in this article arise directly and frequently in QSBS sale transactions. The absence of any IRS guidance on the interaction between section 1045's 60-day requirement and section 453's installment sale rules leaves taxpayers without a clear, low-risk path in the deal structures most common in today's M&A market. The IRS should issue guidance clarifying: (1) whether replacement QSBS can be acquired with noncash consideration or a taxpayer promissory note for purposes of section 1045's purchase requirement; and (2) whether the 60-day reinvestment period commences on the date of closing or the date gain is recognized in an installment sale transaction. Until that guidance is issued, taxpayers and their advisers should evaluate the strategies outlined above with full awareness of the risks involved, document their analysis thoroughly, and, where federal and state tax risk profiles

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permit, consider the immediate cash rollover funded from other sources as the most defensible foundation for a section 1045 election.

Please contact the authors, Scott Dolson or Brian Masterson, if you want to discuss any Section 1202 and Section 1045 issues by video or teleconference. You can also visit the **QSBS & Tax Planning Services page** to read our latest insights and analysis curated by topic.

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[1] To roll over proceeds under section 1045, the taxpayer and the issuing corporation must have met all of section 1202's eligibility requirement, except that the required holding period for the QSBS is only six months.

[2] Taxpayers should take care determining whether amounts held in escrow are treated as held by the taxpayer or the buyer for income tax purposes.

[3] 17 C.F.R. section 230.144 (2026).

[4] *See* Scott W. Dolson, "Substantiating the Right to Claim QSBS Tax Benefits — Part 1," FBT Gibbons (July 15, 2025).

[5] The question of whether a section 351 contribution of cash to a corporation in exchange for replacement QSBS stock qualifies as a purchase within the meaning of section 1045(b)(2) is a related but distinct analytical question addressed separately in Dolson and Brian S. Masterson, "Does a Section 351 Contribution of Money Qualify as a 'Purchase' Under Section 1045?" FBT Gibbons (Feb. 24, 2026). Section 1045(b)(2) defines purchase as an acquisition in which, but for the basis reduction rule of section 1045(b)(3), the taxpayer's unadjusted basis would be cost within the meaning of section 1012. Because section 1012(a) expressly excepts basis rules in subchapter C, including section 358's carryover basis rule applicable to section 351 exchanges, there is a technical argument that the basis of replacement QSBS received in a section 351 exchange is not "cost (within the meaning of Section 1012)," even when the contributed consideration is cash. The planning strategies

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discussed in this article do not depend on resolving that question, as they involve consideration that independently satisfies the section 1012 cost basis standard.

[6] These contextual exclusions are discussed separately in Dolson and Masterson, supra note 5.

[7] *See* reg. section 1.83-3(a); *Alves v. Commissioner*, 734 F.2d 478 (9th Cir. 1984).

[8] *See Lucas v. Earl*, 281 U.S. 111 (1930); and *Helvering v. Horst*, 311 U.S. 112 (1940); compare *Blair v. Commissioner*, 300 U.S. 5 (1937).

[9] *See* reg. section 15A.453-1(c).

[10] *Burnet v. Logan*, 283 U.S. 404 (1931); *Warren Jones Co. v. Commissioner*, 524 F.2d 788 (9th Cir. 1975); reg. section 15A.453-1(d)(2)(iii).

[11] *Iowa v. McFarland*, 110 U.S. 471, 478 (1884).

[12] *Williamson v. Berry*, 49 U.S. 495, 544 (1850).

[13] *See, e.g., Grodt & McKay Realty Inc. v. Commissioner*, 77 T.C. 1221 (1981).

[14] Section 13823, P.L. 115-97 (Dec. 22, 2017).

[15] 15P.L. 119-21, H.R. 1, 119th Cong. (2025).

[16] Section 1400Z-2(d)(2)(B)(ii) provides that "a rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph."

[17] Reg. section 1.1400Z2(a)-1(b)(11)(viii)(A).

[18] *Montgomery v. Commissioner*, 127 T.C. 43, 65 (2006).

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