One Big Beautiful Bill Act Doubles Down on QSBS Benefits for Startup Investors

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After narrowly clearing the House on July 3, the One Big Beautiful Bill Act[1] (OBBBA) was signed into law by President Trump on July 4, 2025. The changes made by OBBBA to Section 1202 generally apply to qualified small business stock (QSBS) issued after July 4, 2025. The old rules apply to QSBS issued prior to July 5, 2025. The changes modernize Section 1202 by raising outdated dollar thresholds and allow investors to tap into Section 1202's tax benefits in as little as three years. This article walks through the key changes to Section 1202 under OBBBA—from shorter holding periods and a bigger exclusion cap to a higher asset threshold—and what they mean for investors looking to make the most of QSBS.

OBBBA's changes to Section 1202 represents a doubling-down of tax benefits focused on encouraging investment in America's start-up companies. Over the years, the QSBS gain exclusion has enjoyed bi-partisan support—Section 1202 was enacted in 1993 during Bill Clinton's presidency, then significantly enhanced during Barack Obama's presidency, and now further enhanced during Donald Trump's presidency. The reduction in the corporate tax rate to 21% during Donald Trump's first term in office coupled with these new Section 1202 amendments sends a clear message that the federal government is in the business of encouraging investment in domestic corporations.

Previous articles included in the QSBS Library have addressed the generous tax benefits associated with QSBS, along with the eligibility requirements that must be satisfied before stockholders are eligible to claim Section 1202's gain exclusion.[2]

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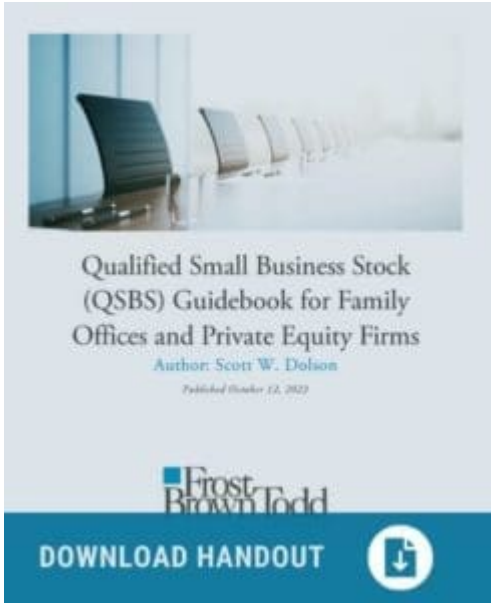

The venture community has strongly supported expanding QSBS's tax benefits. OBBBA includes several amendments to Section 1202 that will impact planning. Although these statutory changes originated in the Senate amendments to OBBBA, elements of OBBBA's Section 1202 amendments were included in the legislation introduced earlier this year by Rep. David Kustoff (R-TN) as part of the proposed Small Business Investment Act.[3] It's relevant to note that Rep. Kustoff's bill arguably would have supercharged Section 1202 by (i) tacking an investor's holding period with respect to a "qualified convertible debt instrument" converted into QSBS to such investor's holding period in the stock itself [4] and (ii) expanding QSBS to include stock in an S corporation.[5]

In connection with the introduction of the Small Business Investment Act, the National Venture Capital Association commented that "*QSBS has a proven track record of promoting long-term investment in high-risk startups across our nation,' said NVCA President and CEO Bobby Franklin. 'NVCA is proud to support Congressman Kustoff's Small Business Investment Act, which would ensure this critical tax incentive continues to help drive innovation and economic growth*'" and describes the Small Business Investment Tax Act as "major progress for QSBS reform."[6] The Angel Capital Association commented that "*Rep. Kustoff's bill will drive the much-needed capital formation from early stage*

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investors across the country that is needed to keep entrepreneurs moving forward with the innovative ideas and companies that will continue to drive economic growth for years to come."[7]

Other Americans have criticized QSBS's tax benefits. OBBBA's enhancements to Section 1202's benefits are likely to spur additional criticism. Professor Victor Fleisher commented that "*a better name [for Section 1202] would be the 'angel investor loophole.' Angel investors and venture capitalists, of course, argue that these are precisely the type of start-ups that tend to create new jobs, and thus they should be encouraged, not taxed. Perhaps the low tax rate encourages angels to put more money into start-ups instead of index funds. On the other hand, it is not clear that the tax break is necessary to encourage investment that would not otherwise take place . . . . Tax is not a first-order consideration.*"[8] Adam Looney blogged that the QSBS gain exclusion "*has little justification on economic grounds, accrues almost entirely to the highest-income taxpayers, and will prove costly with a 20 percent corporate rate; it should be repealed.*"[9] The Treasury disclosed in a report on tax expenditures that Section 1202's gain exclusion was estimated to cost $44.55 billion during the period 2025 through 2034.[10] The Joint Committee on Taxation estimated that OBBBA amendments will increase Section 1202's cost by an additional $17.186 billion over the same period.[11]

Important Takeaways

- **The key date for the OBBBA changes is July 4, 2025**. The "**Effective Date**" for the OBBBA changes is July 4, 2025, the date OBBBA was signed into law. QSBS issued before or on July 4, 2025, is subject to the pre-OBBBA provisions. OSBS issued after July 4, 2025, is subject to the OBBBA changes.
- **Consider whether there is a planning opportunity created by the increase in the per-taxpayer gain exclusion cap from $10 million to $15 million.** Consider whether selling pre-Effective Date QSBS first would maximize a taxpayer's Section 1202 exclusion across both caps.

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- **Pre-OBBBA QSBS cannot be converted into post-OBBBA QSBS**. Section 1202(i) and references to the application of Section 1223 within Section 1202 result in the following: (i) QSBS issued after July 4, 2025, in a Section 351 nonrecognition exchange or a Section 358 tax-free reorganization in exchange for QSBS issued prior to July 5, 2025, will be subject to the pre-OBBBA provisions, and (ii) QSBS issued after July 4, 2025, using proceeds from the sale of QSBS issued prior to July 5, 2025, will be governed by the pre-OBBBA provisions.
- **Allowing taxpayers to obtain a partial gain exclusion after three years should factor in the decision whether to operate a business through a domestic (US) C corporation and make QSBS more attractive to investors**. The five-year holding period requirement definitely factored into deciding whether to operate through a domestic (US) C corporation or consider the potential benefits of QSBS when making an investment in a start-up or qualified small business. And, investing in QSBS issued after the Effective Date should be more attractive with the additional of the partial gain exclusion after three years.

What Has Changed?

Section 1202's five-year holding period requirement is modified to introduce percentage exclusions beginning at three years. Prior to OBBBA's amendment, Section 1202's 100% gain exclusion was available for QSBS issued after 2010 if a taxpayer's holding period exceeded five years. Now, for QSBS issued after the Effective Date, taxpayers can take advantage of a tiered exclusion based on the applicable holding period:[13]

Holding Period	Applicable Exclusion %	Estimated Federal Income Tax Savings[14]
3 years	50%	($119,000 tax savings per $1 million of gain)
4 years	75%	($178,500 tax saving per $1 million of gain)

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5 years or more	100%	($238,000 tax saving per $1 million of gain)

New Section 1202(a)(6)(B) references the determination of a taxpayer's holding period by applying the rules in Section 1223, which generally means that stock-for-stock exchanges and other QSBS transfers won't allow taxpayers holding QSBS issued prior to the Effective Date to exchange their stock for QSBS subject to the modified holding period rules. Further, Section 1223(13) should prevent taxpayers from taking advantage of the modified holding period rules where replacement QSBS is purchased using proceeds from the sale of a taxpayer's QSBS under Section 1045.[15]

The ratcheted holding period amendment will give taxpayers another planning option when they sell QSBS if their holding period falls short of the five-year mark. Other available planning options include structuring a QSBS sale as a tax-free stock-for-stock transaction or reinvesting QSBS proceeds in replacement QSBS under Section 1045. The advantage of the Section 1045 rollover option is that taxpayers are able to both reinvest original QSBS proceeds tax-free and tact their original and replacement QSBS holding periods when the replacement QSBS is sold. The new tiered exclusions are helpful but structuring secondary sales and M&A transactions to allow taxpayers to satisfy the five-year holding period requirement should be a goal given the significant additional tax savings.

The per-taxpayer gain exclusion cap increases from $10 million to $15 million. Prior to amendment, Section 1202 had two separate gain exclusion caps. The first was a cumulative per-taxpayer, per-issuer $10 million cap (the **"$10 Million Cap**"). The second was a cap based on 10 times the aggregate tax basis of QSBS sold by a taxpayer in a given tax year (the "**10X Cap**"). OBBBA does not affect the 10X Cap for QSBS issued before the Effective Date. But for QSBS issued after the Effective Date, the $10 Million Cap is increased to $15 million and includes an annual inflation-adjustment increase. The increase in the cap to $15 million makes sense given the effect of inflation on the value of a $10 million gain exclusion over the past 32 years.[16]

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While the increased gain exclusion cap is welcome and should result in meaningful additional tax savings, the change won't materially affect QSBS planning except perhaps for those individuals whose aggregate gain exclusion falls between $10 and $15 million. The potential for increasing the aggregate gain exclusion using the 10X Cap remains available, as does gift planning (i.e., transferring QSBS to non-grantor trusts, spouses or other taxpayers).

Where a taxpayer has shares of QSBS issued prior to and after the Effective Date, the taxpayer should consider identifying and selling the pre-Effective Date stock first if the taxpayer intends to dispose of Corporation A's QSBS over multiple years. For example, assume the taxpayer is selling $10 million worth of QSBS in a secondary sale in 2032. The taxpayer holds a $10 million pre-Effective Date block of low-basis QSBS and a $10 million post-Effective Date block of low-basis QSBS. If the taxpayer sells the pre-Effective Date block of QSBS during 2032, the taxpayer can claim a $10 million gain exclusion and could claim an additional $5 million gain exclusion if he sells his post-Effective Date QSBS in 2033. If the taxpayer instead sold his post-Effective Date block of Corporation A's QSBS in the 2032 secondary sale, his aggregate gain exclusion for Corporation A's QSBS would be capped at $10 million.

Section 1202's "aggregate gross assets" test amount increases from $50 million to $75 million. Section 1202 is intended to encourage investment in start-ups and qualified small businesses. Section 1202(d)(1) provides that stock issued does not qualify as QSBS unless the corporation is a domestic (US) C corporation whose "aggregate gross assets" both prior to and immediately after the applicable stock issuance do not exceed $50 million. OBBBA increases that $50 million limit to $75 million for QSBS issued after the Effective Date, along with adding future inflation adjustments. This amendment partially addresses the impact of inflation since 1993. Based on a 125.4% cumulative price change from January, 1993 to May, 2025, 1993's $50 million in aggregate gross assets would translate into a $112.7 million in "aggregate gross assets" in 2025.[17] So, while OBBBA's changes are welcome, the increase to $75 million does not fully offset the impact of inflation over the past 32 years.

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OBBBA's $75 million "aggregate gross assets" ceiling should give business owners additional headroom when planning for the issuance of QSBS to investors and employees. In M&A transactions, the increase should provide additional opportunities for issuing QSBS to the buyer-group's principals and employees and target owners participating in equity rollovers. For some start-ups, OBBBA's introduction of full expensing of business properties and domestic research and experimental expenditures will have a further favorable impact by reducing a corporation's "aggregate gross assets"[18]

For QSBS issued after July 4, 2025, Section 1202(d)(1)'s amended "aggregate gross assets" test requires taxpayers to look at whether the QSBS Issuer's "aggregate gross assets" exceeded $75 million at any time prior to the issuance of newly-issued QSBS and immediately after the applicable issuance. For corporations whose "aggregate gross assets" exceeded $50 million prior to July 5, 2025, but never exceeded $75 million, this change will give some corporations who had previously blown through the $50 million mark to now issue additional QSBS. Of course, any corporation whose assets did previously exceed $50 million is likely to be bumping up against or blowing through the $75 million mark if the additional issuance involves a meaningful capital raise. The change could, however, allow corporations falling between the $50 million and $75 million mark to issue additional incentive equity to employees and perhaps if the numbers work, additional rollover equity in M&A deals. Working within the constraints of the now-$75 million test requires careful attention to the calculation of "aggregate gross assets" and what constitutes "immediately after" the applicable issuance.

An additional change made by OBBBA (Section 174A) may have a material impact on some corporation's calculation of "aggregate gross assets" for purposes of the $75 million test. Beginning with the 2022 tax year, corporations were required to capitalize research costs. OBBBA reversed course, allowing for full immediate expensing of domestic research and experimental (R&E/R&D) expenses, with the option to capitalize and amortize those expenses over 60 months. OBBBA also provides options for accelerating expenses of previously capitalized expenses and

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allows eligible small businesses to retroactively expense Section 174 R&E expenditures via amended year 2022 through 2024 returns for eligible small businesses. R&E expenditures that are expensed are not included on the "Section 1202 balance sheet" for purposes of calculating whether a corporation has exceeded the $75 million aggregate gross assets mark, which for some corporations means that there may be significant additional headroom before the corporation fails Section 1202's size test.

Are you ready to turn these new QSBS rules into meaningful tax savings? When business owners learn about the Section 1202 amendments, two questions that immediately come to mind are whether the changes apply to outstanding QSBS and generally how to take advantage of the amendments. As discussed above, the amendments apply only to QSBS issued after July 4, 2025, and the statute includes a reference to Section 1223 intended to restrict conversion of pre-OBBBA QSBS into post-OBBBA QSBS. Assuming there are valid business reasons for issuing additional QSBS, a corporation can now issue additional QSBS for money, property (other than stock) or services to existing and new stockholders and that newly issued QSBS will be subject to the OBBBA amendments. There may be circumstances where valid business purposes exist for a "business freeze" involving the exchange of common for preferred stock and the issuance of additional cheaper common stock. After July 4, 2025, corporations have the ability to issue the new and improved QSBS in connection with capital raises and rollover transactions if their "aggregate gross assets" do not exceed $75 million.

Whether you're a founder, investor or advisor, now's the time to rethink your QSBS planning strategies. Reach out to Scott Dolson or Brian Masterson to schedule a call and explore how you can capitalize on Section 1202's expanded opportunities.

More OBBBA Coverage

The One Big Beautiful Bill Act stands to fundamentally reshape the fiscal landscape across key sectors, introducing both immediate compliance challenges and long-term planning imperatives for

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businesses. This collection of articles sheds light on the OBBBA's key components to help you better understand and prepare for the changes ahead while taking advantage of the new tools (and tradeoffs) offered by the OBBBA.

View Collection

[1] H.R. 1, 119th Cong. § 70431 (2025).

[2] References to "Section" are to sections of the Internal Revenue Code of 1986, as amended.

[3] H.R. 1199, 119th Cong. (2025).

[4] H.R. 1199, 119th Cong. § 3 (2025).

[5] H.R. 1199, 119th Cong. § 4 (2025).

[6] Major Progress for QSBS Reform—Maintaining the Momentum – Angel Capital Association

[7] Congressman Kustoff Introduces the Small Business Investment Act | Congressman David Kustoff

[8] 'Tax Extenders' That Slip Under the Radar – The New York Times

[9] Adam Looney, The Brookings Institution, Up-Front Blog, "*The next tax shelter for wealthy Americans: C-corporations*" (November 30, 2017). Looney's blog focused on proposals to reduce the corporate income tax rate to 20% in connection with a bill that ultimately was enacted as the Tax Cuts and Jobs Act of 2017.

[10] Tax Expenditure Budget for Fiscal Year 2026

[11] JCX-29-25 | Joint Committee on Taxation

[12] In general, the enactment date of tax legislation is the date the president signs the bill into law. See PWC "*Determining the enactment date*" at Determining the enactment date.

[13] If a taxpayer takes advantage of the 50% or 75% exclusion, the portion not eligible for the Section 1202 gain exclusion would be taxed at a 28% tax rate, but would not be treated as a preference item for purposes of the alternative minimum tax. OBBBA does not change the tax treatment under Section 1202 of QSBS acquired prior to September 27, 2010.

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[14] Assumes a combined effective federal tax rate of 20% (long-term capital gains) plus 3.8% (net investment income tax rate).

[15] Section 1223(13) provides that: "*Except for purposes of subsections (a)(2) and (c)(2)(A) of section 1202, in determining the period for which the taxpayer has held property the acquisition of which resulted under section 1045 or 1397B in the nonrecognition of any part of the gain realized on the sale of other property, there shall be included the period for which such other property has been held as of the date of such sale.*"

[16] The U.S. Bureau of Labor Statistics indicates that in order to keep up with inflation from January 1, 1993, to May, 2025, the gain exclusion would need to be approximately $22.5 million. See CPI Inflation Calculator.

[17] See the U.S. Bureau of Labor Statistics CPI Inflation Calculator which uses the Consumer Price Index for All Urban Consumers (CPI-U).

[18] See Senate Version of H.R. 1, Sections 70301 and 70302. The enhanced expensing provisions will have the effect of moving assets off of the QSBS "aggregate gross assets" balance sheet that would have previously been included in the calculation.

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