



What Is a Qualified Small Business Stock?

A Potentially Powerful Tax Planning Tool for Founders.

Qualified small business stock (QSBS) refers to shares issued by a U.S. C-corporation that meet the requirements under Section 1202 of the Internal Revenue Code. When the criteria are satisfied, eligible shareholders may exclude a significant portion of capital gains from federal taxation, making QSBS a potentially powerful tax planning and mitigation strategy to founders, early employees, and investors.

A QSBS can potentially reduce the tax impact of the eventual sale of qualifying stock. With proper planning, shareholders may potentially eliminate a large portion of capital gains that would otherwise be taxable.

Key Requirements

To qualify as a QSBS, all the following must generally be met:

1. Issued by a U.S. C-Corporation

The business must be organized as a U.S.-based C Corporation with stock issued after August 10, 1993.

2. Asset Threshold

Depending on when the shares were acquired:

- Pre-July 5, 2025: Company must have had \leq \$50 million in aggregate gross assets at issuance.
- Post-July 4, 2025: Limit increases to \leq \$75 million indexed for inflation in future years.

3. Original Issuance

Stock must be acquired directly from the corporation or an underwriter. QSBS received by gift or at death of the original holder may still qualify.

4. Active Business Requirement

At least 80% of corporate assets must be used in active business operations (not investment, finance, or disqualified service fields).

5. Holding Period

The required holding period depends on when the stock was acquired.

Pre-July 5, 2025 stock:

- Held more than five years: 100% exclusion

Post-July 4, 2025 stock:

- Held three years a 50% exclusion
- Held four years a 75% exclusion
- Held five years a 100% exclusion

How QSBS Can Potentially Reduce Taxes

Section 1202 allows qualifying shareholders to potentially exclude a substantial portion of capital gains from federal taxation when selling QSBS.

The amount of gain eligible for exclusion is capped at the greater of:

- A fixed dollar limit — up to \$15 million of qualifying gain for stock acquired post-July 4, 2025, on a per-issuer basis; or
- A basis multiple — up to 10 times the taxpayer's adjusted basis in the QSBS sold.

These limits apply on a per-issuer, per-taxpayer basis and are available only to the extent the applicable holding-period requirements and exclusion percentages are met. When fully utilized, this structure can potentially reduce – or in some cases eliminate – federal capital gains tax on the sale of highly appreciated QSBS.

Who Benefits Most

QSBS may be especially valuable for:

- Founders receiving early-stage equity
- Early employees with stock grants
- Angel investors or seed-stage investors
- Entrepreneurs planning for a future exit

QSBS offers a potentially powerful tax planning opportunity to shareholders of qualifying small businesses. Understanding the rules – particularly around timing, structure, and eligibility – can significantly reduce tax exposure when selling appreciated stock.

Stifel does not provide legal or tax advice. You should consult with your legal and tax advisors regarding your particular situation.

For more info, please contact:

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