Hughes Hubbard & Reed

Expansion of Qualified Small Business Stock Tax Benefits

Client Advisories

Hughes Hubbard & Reed LLP • A New York Limited Liability Partnership
One Battery Park Plaza • New York, New York 10004-1482 • +1 (212) 837-6000

July 9, 2025 – On July 4, President Donald Trump signed a budget reconciliation bill entitled the "One Big, Beautiful Bill Act" (the Act). The Act extends the tax cuts that were enacted as part of the Tax Cuts and Jobs Act of 2017, adds a number of additional tax breaks and includes cuts in spending.

The Act includes a provision that provides a significant benefit to venture capital funds and other investors in start-ups. This provision expands tax benefits provided under Section 1202 of the Internal Revenue Code for the sale of qualified small business stock (QSBS). Prior to the Act, a noncorporate taxpayer may exclude from its income gains from the sale or exchange of QSBS held for more than five years (taking into account certain holding period tacking rules) in an amount up to the greater of 10 times its aggregated adjusted basis in its QSBS (Adjusted Basis Cap) or $10 million (reduced by the amount of the exclusion previously used). Generally, QSBS is stock in a domestic C corporation that was acquired (or deemed acquired) by the taxpayer at its original issuance if, immediately after the issuance, the adjusted basis of the corporation's gross assets (including cash) does not exceed $50 million and the corporation satisfies an active business requirement during substantially all of the taxpayer's holding period. Special rules apply to pass-through entities. The Act makes three major changes to Section 1202.

1. Increased Gross Assets Limitation for Qualifying Businesses

The Act raises the maximum gross asset limitation for a corporation to be a qualifying small business from $50 million to $75 million (now adjusted for inflation). The increased threshold applies to stock issued after July 4, 2025.

2. Implementation of a Tiered Exclusion Schedule

Under the law in effect prior to the Act, a taxpayer did not receive a capital gain exclusion if it held the QSBS for five years or less. The Act establishes a partial exclusion for taxpayers who sell their stock before the expiration of the five-year period. Under the new scheme, an investor who acquires QSBS after July 4, 2025 (determined taking into account certain holding period tacking rules), who held the QSBS for at least three years at the time of sale, receives a 50% exclusion and for four years receives a 75% exclusion. The 100% exclusion for QSBS held for at least five years remains in effect.

3. Increased Cap on Capital Gains Eligible for Exclusion

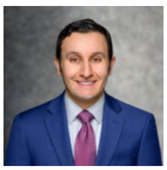
The Act raises the cap on the amount of capital gains eligible for exclusion, from the greater of the Adjusted Basis Cap or $10 million to the greater of the Adjusted Basis Cap or $15 million (now adjusted for inflation) for QSBS that is acquired after July 4, 2025 (determined taking into account certain holding period tacking rules). This is a significant change, as the per-issuer cap amount had remained the same since Section 1202's original enactment in 1993.

The Act provides a great opportunity for investors to acquire stock in start-up companies. We are here to help you navigate through the complex QSBS rules.

Related People

Andrew H. Braiterman

Alan Kravitz



Justin S. Cohen

Related Areas of Focus

Tax