



TAX NEWS & VIEWS PODCAST

Episode - QSBS decoded: OBBBA's impact on your tax planning

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Carrie Falkenhayn: From Deloitte Tax, welcome to the Tax News and Views podcast. In this series, we talk to specialists from Deloitte about the latest business issues and developments. I'm Carrie Falkenhayn, your host for Tax News and Views. And today, we're going to be talking about qualified small business stock. We'll probably use the acronym QSBS and we're going to talk about what that is, some changes that were introduced as part of the One Big Beautiful Tax Bill, or OB3. As well as considerations we're seeing from both an entity and an owner perspective. Joining me today to discuss these developments are two specialists from Deloitte's Washington National Tax Group. We have, with us today Victoria Glover and Jared Lowe. And Victoria, why don't you get us started? I think a quick overview of the general benefits and requirements for QSBSs, what they are, for taxpayers, and then we can get into some of the changes that came about.

Victoria Glover: Sure, thanks, Carrie. So, very generally, qualified small business stock, the benefit of that is that it provides up to 100% exclusion to certain taxpayers if you hold qualified small business stock for more than 5 years, and then sell it after that. And so, on the net capital gain from the sale of qualified small business stock, up to 100% can be exempt for purposes of, you know, certain taxpayers, such as individuals and certain trusts and estates. And, in addition taxpayers can own qualified small business stock, either directly, or they can own it indirectly through pass-throughs, such as partnerships or S-Corps. And as long as the taxpayer, the pass-through, and the company, which is the qualified small business, meets certain

requirements, then the ultimate taxpayer, the individual, can potentially receive up to the 100% exclusion. And so, before getting into the changes that were enacted last year, and what's commonly known as the One Big Beautiful Bill, or shorthand OB3, there are a number of strict requirements that apply at the taxpayer level, as well as the company level, and including also for pass-throughs, when a taxpayer owns through its qualified small business stock through a pass-through. And some of those requirements at the company level is that it needs to be a qualified small business, so, it's the business's gross assets need to be below a certain threshold when stock is issued, and prior to OB3, it was \$50 million, so what is known as a small business. And then, in addition that small business, that company, needs to be operating a business, but not a service business. So, it can't be operating, if it was in a business of brokerage, or consulting, or financial services, those are bad businesses for purposes of 1202, and the ultimate taxpayer, the individual, wouldn't receive the benefit. And then there are also other requirements that apply at, ultimately, the taxpayer level. That Jared will discuss later. But let's get into some of the changes that were enacted in the OB3 and there were 3 significant changes. The first change I had, from the company perspective is that the gross asset threshold that I had mentioned before, which was \$50 million of gross assets for potentially stock-issued, could qualify for stock issued after July 4th, the gross asset threshold has been increased to \$75 million, which is, which is a helpful rule. In addition, I had mentioned in the beginning that qualified small business stock applies to stock that's held for more than 5 years. And the net capital gain on the sale of the stock, potentially could qualify for that 100% exclusion. And so, what OB3 did was that it provided this tiered exclusion, system, such that if you own if you own stock for more than 3 years and then sell it, but less than 4 years. You can get a 50% exclusion. If you own for, more than 4 years, but less than 5 years, you could get a 75% exclusion. And if you own for more than 5 years, you can get 100% exclusion. So those were some very helpful benefits that were enacted in OB3. And then last, at the taxpayer level, there's a general exclusion for the tax year from qualified small business stock of \$10 million. That exemption threshold was increased for the taxpayer to \$15 million as part of the OB3 changes.

Carrie Falkenhayn: So those changes create a lot of flexibility and likely have more organizations considering how they might, take advantage of these rules. What are we seeing partnerships, as well as their partners, consider?

Victoria Glover: I think since OB3 was enacted, there has been a lot of interest, from both partners and partnerships, especially from maybe private equity or venture capital. Especially if they have operating businesses already. And so, one of the requirements is that the qualified small business has to be held in a domestic C-Corp. So, we are seeing some partnerships consider, maybe it might make sense to incorporate. There's a lot of other nuanced considerations and, you know, tax issues that you would need to consider, but that is something that partners and partnerships are considering. And I think also, given the flexibility that's been provided now, especially the tier gain exclusion system and the increase in the gross asset threshold that more businesses could potentially qualify now, and so I think that's been really helpful for, you know, ultimately partners and partnerships who invest and acquire qualified small business stock.

Carrie Falkenhayn: So that's really helpful to understand from the entity perspective. Jared, jump in here and talk about what taxpayers can do today, as investors to take advantage of these new provisions for qualified small business stock.

Jared Lowe: Sure, I think there's, you know, a couple different things that they can do. One is, you know, to directly invest in stock of companies that qualify. They also are able to buy an interest in a partnership, and if that partnership purchases qualified stock, they will also receive the benefit there. I think it's very important to remember that these rules are really complicated and require discipline tracking. Not just tracking of the QSPS holdings, but also, you know, when are you going to sell them?

How long are you going to keep them? And I think that it's important to remember, that consideration should be given with respect to the interaction with other code sections. For example, if a taxpayer has generated a capital loss, and it's not 1202 stock. And then they have the option of selling that stock or

selling stock that is not QSBS eligible it may be advantageous to sell the stock that's not eligible, because you'll want to use that gain to offset the loss from other stock sales. So, it's not always maybe the most tax advantageous to, you know, sell your 1202 stock, and you gotta look at your overall tax posture in order to, you know, maximize the benefit.

Carrie Falkenhayn: So, when we look at Section 1202, very generally, the stock must be acquired at its original issuance for money or services, and I understand there are only limited exceptions to this rule. Can you talk about what some of those exceptions might be?

Jared Lowe: Yes, the original issuance requirement may be deemed to have been satisfied if the stock is acquired by gift at death. Providing the gift, the deceased taxpayer purchased the stock at its original issuance. So, it's very important that somebody purchase at the original issuance, and then that sort of original issuance purchase is deemed to transfer over to the person receiving the gift or the distribution from the estate. It's also a valid transfer and counts as the exception when a partnership distributes qualified small business stock to its partner.

Carrie Falkenhayn: So, if an individual purchases qualified small business stock directly at its original issuance, will subsequent tranches of stock also qualify for the gain exemption?

Jared Lowe: It could, because the tranches of stock issuance that qualify isn't just the first one, it's really any stock issuance that meets the requirements, you know, the \$75 million gross asset test has been satisfied. And so, it definitely could. However, not necessarily, because you have to look at the requirements of the shareholder for each separate trunk. So, for example, stock in a corporation shall not be treated as qualified small business stock unless during substantially all of the taxpayer's holding period for such stock such corporation meets the active business requirement. So, if a individual shareholder purchases stock tranches at different times. You know, depending upon the facts of the corporation, maybe one of them, for substantially all of the time the active business requirement has been met, and maybe the other one, it has not.

Carrie Falkenhayn: All right, well, thank you both for sharing those insights. It sounds like Section 1202 offers significant benefits, but like so many areas of the tax law, it comes with significant requirements that could, that need to be worked through to make sure that the qualifications are met to receive those benefits. Thank you for sharing that, and I'm sure this just creates additional questions, maybe, that our audience has. If the audience would like to stay up to date on current tax legislative developments, I would encourage you to sign up for the weekly tax news and views email. I would just, enter the search engine of your choice, just type in Tax News and Views, and you're gonna find a link where you can subscribe to the weekly newsletter. As always, audience, we hope you join us for the next episode, and until then, be well, everyone.

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