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One Big Beautiful Bill Act, H.R. 1 – 119th Congress (2025-2026): Part V – Qualified Small Business Stock Exclusion / Code Section 1202

By Larry Brant and Steven Nofziger on 7.22.25 | Posted in Federal Law, Legislation, Tax Laws

In this fifth installment of my multi-part series on the One Big Beautiful Bill Act, Steve Nofziger and I discuss a provision of the Act that impacts certain business owners who are contemplating a sale of their shares, Code Section 1202.[1]

Background

Code Section 1202 has a rich history. It was originally enacted over three decades ago as part of the Revenue Reconciliation Act of 1993. It was one of many provisions of that legislation aimed at stimulating the investment in closely held businesses. Congress tinkered with Code Section 1202 over the following years, enhancing the benefits it offered small business owners. In 2009, as part of the American Recovery and Reinvestment Act of 2009, Congress temporarily increased the amount of gain exclusion offered under this provision. The next year, as part of the Small Business Jobs Act of 2010, Congress temporarily increased the gain exclusion in limited circumstances to 100%. Impetus for that amendment to Code Section 1202 (increasing the benefit to 100%) was recognition by lawmakers that many taxpayers that otherwise qualified for gain exclusion under Code Section 1202 were not able to take advantage of it due to other provisions of the Code (e.g., the individual alternative minimum tax). The 100% exclusion, however, enhanced the benefit so that taxpayers subjected to the alternative minimum tax would see some benefit from the application of Code Section 1202. Accordingly, as part of the Protecting Americans from Tax Hikes Act of 2015, Congress made the 100% exclusion permanent. Consequently, the selling shareholders of a closely held corporation and their tax advisers today need to evaluate the application of Code Section 1202.

The One Big Beautiful Bill Act (the "Act"), signed into law by President Trump on July 4, 2025, made several significant changes to the existing framework for the exclusion of capital gains from the sale of qualified small business stock ("QSBS") under Code Section 1202.

Prior to the Act, Code Section 1202 allowed noncorporate taxpayers holding QSBS for more than five years to exclude from gross income certain eligible gain realized upon the taxable sale or other disposition of the stock. The percentage of the gain allowed to be excluded is 50%, 75% or 100% depending on when the stock was acquired:

- The exclusion percentage is 50% for stock acquired between August 11, 1993, and February 17, 2009;
- The exclusion percentage is 75% for stock acquired between February 18, 2009, and September 27, 2010; and
- The exclusion percentage is 100% for stock acquired on or after September 28, 2010.

For purposes of Code Section 1202, QSBS is stock in a domestic C corporation acquired at original issue for money, property (other than stock) or services. The issuing corporation must be a "qualified small business" and meet an active business test for substantially all of the taxpayer's holding period of the stock. For this purpose, a "qualified small business" is defined as a business with aggregate gross assets (cash and the adjusted basis of its assets) of $50 million or less at all times between August 10, 1993[2], and immediately after the stock issuance. Further, at least 80% of the corporation's assets (by value) must be used in the active conduct of a trade or business during substantially all of the taxpayer's holding period of the QSBS. Lastly, the corporation cannot be engaged in providing health, law, consulting, accounting, finance, farming, mining or hospitality services.

Code Section 1202 contains several limitations, including a "per-issuer" limitation under which the aggregate amount of eligible gain that can be taken into account with respect to stock issued by the corporation cannot exceed the greater of:

- $10 million ($5 million for married taxpayers filing separate returns) minus the aggregate amount of eligible gain excluded for earlier tax years with respect to stock of the corporation; and
- 10 times the taxpayer's aggregate adjusted basis in QSBS issued by the corporation and disposed of by the taxpayer in the tax year.

Other technical nuances with respect to the Code Section 1202 gain exclusion include:

- Any non-excluded "Section 1202 gain" (i.e., the excess of gain that would be excluded from gross income under Code Section 1202 but for the percentage limitation in Section 1202(a) above the amount excluded) is taxed at a maximum 28% rate, rather than the 20% maximum rate for long-term capital gains;[3]

- 7% of the excluded gain is treated as a preference item for alternative minimum tax ("AMT") purposes;[4] and
- The Code Section 1411 net investment income tax ("NIIT") applies to amounts above the NIIT income thresholds.

The Act's Impact on Code Section 1202

The Act made several significant changes to the Code Section 1202 exclusion framework:

- The exclusion percentage is now phased in in three steps based upon the length of time the stock was held;
- The "per-issuer" limitation has been increased, and an inflation adjustment has been added;
- The gross asset limitation in the definition of "qualified small business" has been increased, and an inflation adjustment has been added; and
- The excluded gain is no longer an AMT preference item.

The Act did not make any changes with respect to the treatment of non-excluded gain or NIIT treatment. Thus, any non-excluded "Section 1202 gain" is still taxed at a maximum rate of 28%, and the excluded gain may still be subject to NIIT.

Practice Alert: The pre-Act framework continues to apply to QSBS acquired before enactment of the Act. The new Code Section 1202 rules only apply to QSBS issued after the Act was enacted (i.e., after July 4, 2025).

New Tiered Exclusion Percentage

For QSBS issued after enactment of the Act, the previous five-year holding period rules have been modified to allow the exclusion to commence as follows:

- For stock held at least three years (but less than four years), the exclusion percentage is 50%;
- For stock held at least four years (but less than five years), the exclusion percentage is 75%;

- For stock held at least five years, the exclusion percentage is 100%.

Thus, taxpayers can obtain the benefits of the gain exclusion up to two years earlier than under the pre-Act rules. **Again, these new rules only apply to QSBS issued after July 4, 2025.**

Expanded Per-Issuer Limitation

As noted above, the per-issuer limitation is a limitation with a two-pronged test under which excluded gain is limited to the greater of (i) a specified dollar limit or (ii) 10 times the taxpayer's aggregate adjusted basis in the stock.

For QSBS issued after July 4, 2025, the per-issuer limitation has been increased to $15 million (up from the pre-Act limit of $10 million). This limit will also be indexed for inflation in $10,000 increments, starting in 2026.

The 10-times-basis prong of the limitation remains unchanged. However, since the per-issuer limitation is the greater of $15 million or 10 times the taxpayer's aggregate adjusted basis, the increased dollar limitation can lead to meaningful additional tax savings for taxpayers whose gain is not subject to the 10-times-basis prong.

Importantly, in the case of married taxpayers filing separately, the dollar limitation remains at one half of the applicable limitation otherwise in effect—i.e., $5 million in the case of stock issued prior to the Act and one half of the applicable inflation-indexed amount for post-Act stock issuances (e.g., starting at $7.5 million).

Increased Gross Asset Limitation

The Act also increased the gross asset limitation in the definition of “qualified small business” to $75 million (up from $50 million) and provides a similar inflation adjustment in $10,000 increments, starting in 2026.

This change will allow taxpayers to invest in larger, slightly more mature corporations and have the newly issued stock qualify as QSBS. This change enlarges the pool of corporations that will qualify as a “qualified small business,” potentially increasing the number of shareholders who can utilize the Code Section 1202 gain exclusion.

Potential Planning Opportunities

The changes to Code Section 1202 create planning opportunities for shareholders of qualified small businesses. Shareholders of qualified small businesses may be able to utilize the benefits of the QSBS exclusion sooner (e.g., gain exclusion available after only three years). The benefit may be greater due to the higher per-issuer limitation. Also, the exclusion may be available with respect to a greater pool of corporations (due to the increased gross asset

limitation).

One planning consideration that taxpayers and practitioners must be aware of is the mechanics of how the per-issuer limitation is applied. The $10 million per-issuer limitation for pre-Act acquired shares and the $15 million per-issuer limitation for post-Act acquired shares are **not** separately applied. With respect to both types of shares, the limit for any tax year is computed for each tax year by reducing the applicable dollar limit (i.e., $10 million or $15 million) by the eligible gain excluded in prior years "attributable to dispositions of stock issued by such corporation and acquired by the taxpayer *before, on, or after*" July 4, 2025. (Emphasis added.)

The computational mechanics arising from the statute's use of the phrase "before, on, or after" means that, for a particular tax year, all shares previously sold for which gain was excluded under IRC Section 1202 must be taken into account regardless of whether those shares were acquired pre-Act or post-Act. This means that a taxpayer's sale of post-Act shares will count against the $10 million limit allowed for sales of pre-Act shares in subsequent years.

The following example clearly illustrates this issue.

EXAMPLE: Taxpayer owns shares of a qualified small business that are worth $40 million. She has zero basis in the QSBS, which were acquired at different times, but all of which have been held for more than 5 years. Taxpayer desires to sell one quarter of the shares for $10 million. $30 million of the unrealized gain is attributable to pre-Act shares, and $10 million is attributable to post-Act shares.

Scenario A – Taxpayer Sells Pre-Act Shares First: If the taxpayer sells $10 million (out of the $30 million) of pre-Act shares, those shares would be subject to the pre-Act $10 million per-issuer limitation and allow the taxpayer to preserve the opportunity to exclude up to an additional $5 million of gain on subsequent sales of post-Act shares in later years. That is, the taxpayer could subsequently sell post-Act shares and obtain the benefit of up to an additional $5 million of gain exclusion ($15 million total less $10 million of excluded gain on prior sales) on those shares.[5]

Scenario B – Taxpayer Sells Post-Act Shares First: If, however, the taxpayer instead sells all $10 million of post-Act shares, the gain from those shares would count against the available gain exclusion for pre-Act shares sold in subsequent years, for which there's still a $10 million limitation. Thus, if the post-Act shares are sold first, that $10 million of gain exclusion would effectively use up the entire $10 million limitation allowed in respect of all sales of pre-Act shares, such that the taxpayer would not be able to exclude any additional gain when selling pre-Act shares in later years. Said another way, in this scenario, if the taxpayer sells post-Act shares first, the taxpayer can only exclude a total of $10 million of gain, and the taxpayer loses the benefit of the additional $5 million gain limitation provided by the Act. This is a wrinkle in

the law that needs careful consideration by taxpayers and their advisers.

The example illustrates that timing matters with respect to Code Section 1202. Based on the facts presented above, the taxpayer should clearly sell pre-Act shares first, which would be subject to the pre-Act $10 million per-issuer limitation and allow the taxpayer to preserve the opportunity to exclude up to an additional $5 million of gain on subsequent sales of post-Act shares in later years.

Advanced planning for sales of QSBS is now required more than ever before. When sales of QSBS will be occurring over multiple tax years, practitioners and taxpayers need to properly plan for the timing of the sales, taking into account the mechanics of the per-issuer limitation. Further, it is vital that they: (i) document the acquisition dates and holding periods for each particular lot of shares; and in each sale, and (ii) document which particular lots of shares are being sold. Given the mechanics of the per-issuer limitation, taxpayers will likely find it advantageous to sell pre-Act shares prior to selling any post-Act shares.

Conclusion

The Act significantly enhances the benefits of Code Section 1202 by introducing a new tiered system for gain exclusion, increasing the per-issuer limitation (and thus the maximum exclusion), raising the gross asset threshold to determine eligible qualified small businesses, and eliminating the excluded gain as an alternative minimum tax preference. These changes offer flexibility and enhanced tax benefits for shareholders of qualifying small businesses. Of course, as illustrated by our discussion, complexity accompanies the enhancements. Before selling the shares of a closely held C corporation, taxpayers and their advisers need to look closely at the application of Code Section 1202.

Stay tuned for more installments on other provisions of the One Big Beautiful Bill Act.

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[1] All references to the Code are to the Internal Revenue Code of 1986, as amended.

[2] The date of enactment of the Revenue Reconciliation Act of 1993.

[3] *See* IRC Section 1(h)(4), (7).

[4] *See* IRC Section 57(a)(7).

[5] Subsequent sales of additional pre-Act shares would not be eligible for any gain exclusion because the $10 million limit would be reduced to $0 as a result of the prior $10 million gain exclusion.

Tags: gross asset limitation, OBBBA, per-issuer limitation, qualified small business stock, shareholders, The One Big Beautiful Bill Act