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### One Big Beautiful Bill Act Reinforces and Enhances Qualified Small Business Stock Tax Savings – A Benefit for Prospective Startup Investors

By: Steven R. Cole (Member) and Matthew A. Slipchuk (Senior Associate), Tax Practice Group

The One Big Beautiful Bill Act ([H.R. 1, 119<sup>th</sup> Cong § 70431 \(2025\)](#)) (“Act”) was signed into law by President Trump on July 4, 2025, after narrowly passing the House on July 3, 2025. The Act amends Section 1202 of the Internal Revenue Code (“Code”), but such changes generally apply only to qualified small business stock (“QSBS”) issued after July 4, 2025. Thus, the old rules generally apply to QSBS issued prior to that date. The Act modernizes Section 1202 of the Code, increasing the dollar limitations for qualification and enabling investors to benefit from Section 1202 tax savings in as little as three years. **This Bodman Tax Law Update summarizes these changes and provides commentary on what these changes mean for founders and investors looking to make the most of the tax benefits of QSBS.**

#### Overview of Section 1202

Section 1202 provides each non-corporate taxpayer with an unmatched opportunity to exclude up to 100% of capital gains (for stock acquired after September 27, 2010) upon a sale of QSBS if all eligibility requirements have been met. For stock to qualify as QSBS, such stock must be issued by a qualifying domestic C corporation and must be acquired directly from the corporation for money, property (not including stock), or services. In addition, the corporation must have met certain aggregate gross asset tests both before and immediately after the stock issuance. Moreover, (i) the corporation must be actively engaged in a qualifying trade or business, (ii) the stockholder must not have held any offsetting short positions during the first five (5) years of ownership, (iii) the stockholder and related persons must not have participated in anti-churning redemptions by the issuing corporation within a two-year window period, and (iv) the corporation must not have engaged in any significant stock redemptions within a four-year window period. Among the businesses excluded from this benefit are certain service businesses (such as health, law, engineering, architecture and accounting), banking, insurance or financing businesses, farming and hotel or restaurant businesses.

## Key Changes Under the Act

### (i) The Act Introduced Tiered Percentage Exclusions

Prior to the Act, Section 1202's 100% gain exclusion was available for QSBS issued after September 27, 2010, if the taxpayer held the QSBS for greater than five years. For QSBS issued after July 4, 2025, taxpayers may now take advantage of gain exclusion on the following tiered holding-period schedule:

Holding Period	Applicable Gain Exclusion	Estimated Federal Income Tax Savings (assuming a federal tax rate of 20% (long-term capital gains rate) plus 3.8% (net investment income tax rate))
3 years from issuance	50%	\$119,000 of tax saving per \$1 million of gain
4 years from issuance	75%	\$178,500 of tax savings per \$1 million of gain
5 years from issuance	100%	\$238,000 of tax savings per \$1 million of gain

The Act thus provides qualifying taxpayers with additional planning flexibility by allowing partial tax benefits even if the QSBS is sold before the five-year mark.

### (ii) Gain Exclusion Cap Increases from \$10 million to \$15 million

Prior to the Act, Section 1202 enabled taxpayers to exclude the greater of two separate caps. First, was a cumulative cap for each taxpayer of \$10 million per issuing corporation. Second, was a cap based on ten times the aggregate tax basis of the taxpayer in the issuer's QSBS sold in a given tax year. The Act does not change second "ten times" cap. However, for QSBS issued after July 4, 2025, the \$10 million dollar cap is increased to \$15 million. This new \$15 million gain exclusion cap is also subject to annual inflation-related adjustments beginning in 2027.

### (iii) Issuing Corporation's Gross Asset Test Increases to \$75 Million

As a qualification matter, prior to the Act, Section 1202 provided that stock issued by a domestic corporation does not qualify as QSBS unless the corporation's "aggregate gross assets" both prior to and immediately after the applicable stock issuance do not exceed \$50 million. The Act increases this amount to \$75 million and includes an adjustment for inflation. This should result in more businesses being able to issue QSBS to both investors and employees, as more businesses will qualify at later stages to issue QSBS.

## Planning Opportunities

### (i) For Founders and Investors

The new tiered-gain exclusion explained above provides flexibility for early-stage investments, as investors can exit after three years and still receive a partial tax benefit. This change should encourage additional investment in startups and mature businesses because the holding period for QSBS benefits is not quite as long.

### (ii) For M&A Transactions

The increase in the gross-asset test to \$75 million and the inflation adjustment mechanism should increase the number of companies that will be able to issue QSBS to employees and investors, spurring additional investment. For M&A transactions, the increase should provide additional opportunities for issuing QSBS to the buyer-group's principals and employees and to target owners participating in equity rollovers. Investment opportunities may be more attractive when considering the ability to obtain QSBS benefits in as early as three years.

**If you have any questions about Section 1202**, please contact your Bodman attorney or a member of Bodman's Tax Practice Group listed here (including the authors, Matt Slipchuk or Steve Cole). Bodman cannot respond to your questions or receive information from you without first clearing potential conflicts with other clients. Thank you for your patience and understanding.

<b>TAX PRACTICE GROUP</b>	<b>STEVEN R. COLE</b> Co-Chair 248-743-6074 <a href="mailto:scole@bodmanlaw.com">scole@bodmanlaw.com</a>	<b>WAYNE D. ROBERTS</b> Co-Chair 616-205-1872 <a href="mailto:wroberts@bodmanlaw.com">wroberts@bodmanlaw.com</a>	<b>CELESTE E. ARDUINO</b> 248-743-6038 <a href="mailto:carduino@bodmanlaw.com">carduino@bodmanlaw.com</a>
	<b>CONOR M. BOWERS</b> 313-393-7572 <a href="mailto:cbowers@bodmanlaw.com">cbowers@bodmanlaw.com</a>	<b>KELLY M. BURNELL</b> 313-393-7514 <a href="mailto:kburnell@bodmanlaw.com">kburnell@bodmanlaw.com</a>	<b>ANTHONY P. CRACCHIOLO</b> 248-743-6059 <a href="mailto:acracchiolo@bodmanlaw.com">acracchiolo@bodmanlaw.com</a>
	<b>ANDREW H. CUROE</b> 313-393-7546 <a href="mailto:acuroe@bodmanlaw.com">acuroe@bodmanlaw.com</a>	<b>TIMOTHY R. DAMSCHRODER</b> 734-930-0230 <a href="mailto:tdamschroder@bodmanlaw.com">tdamschroder@bodmanlaw.com</a>	<b>FORREST O. DILLON</b> 313-393-7513 <a href="mailto:fdillon@bodmanlaw.com">fdillon@bodmanlaw.com</a>
	<b>ERIN M. HANEY</b> 616-205-1867 <a href="mailto:ehaney@bodmanlaw.com">ehaney@bodmanlaw.com</a>	<b>EMILY J. KWOLEK</b> 248-743-6048 <a href="mailto:ekwolek@bodmanlaw.com">ekwolek@bodmanlaw.com</a>	<b>DAVID P. LARSEN</b> 313-393-7575 <a href="mailto:dlarsen@bodmanlaw.com">dlarsen@bodmanlaw.com</a>
	<b>PAUL V. MCCORD</b> 616-205-4269 <a href="mailto:pmccord@bodmanlaw.com">pmccord@bodmanlaw.com</a>	<b>MATTHEW A. SLIPCHUK</b> 313-393-7585 <a href="mailto:mslipchuk@bodmanlaw.com">mslipchuk@bodmanlaw.com</a>	<b>DAVID B. WALTERS</b> 248-743-6052 <a href="mailto:dwalters@bodmanlaw.com">dwalters@bodmanlaw.com</a>