

# What is QSBS and Why is it Important Now?

January 10, 2022



In today's financial climate, many people have become increasingly interested in an area that is not necessarily new, but is often overlooked or misunderstood – opportunities related to “Qualified Small Business Stock” (QSBS). The Internal Revenue Code outlines complex tax rules and a variety of criteria for entities to qualify for a tax incentive that has proven valuable for many businesses and investors alike.

The QSBS exclusion was enacted in 1993. This part of the tax code has been gaining importance in recent years within the growing areas of venture capital, startups, fintech and the ever-changing tax laws. The QSBS benefit excludes from gross income a portion of capital gain realized on the sale of QSBS. This benefit incentivizes investors to add these investments to their portfolios as the tax benefits for QSBS increase investors' Return on Investment (ROI). The gain that may be excluded for federal purposes is the greater of \$10 Million or 10 times the basis of your stock. The rules for state exclusion will vary based on your state of residence.

Below is a table for the exclusion amounts by the applicable acquisition dates of the investment:

| Acquisition date      | Regular income tax exclusion percentage | AMT add back percentage |
|-----------------------|-----------------------------------------|-------------------------|
| 8/10/93-2/17/2009     | 50%                                     | 7%                      |
| 2/18/2009 – 9/27/2010 | 75%                                     | 7%                      |
| After 9/27/2010       | 100%                                    | 0%                      |

Below are the basic qualifications to ensure the investment qualifies for the QSBS exclusion:

- The stock must be originally issued as a domestic C Corporation. The stock cannot be purchased through a secondary market.
- The gross assets of the corporation must not be more than \$50 million before and immediately after issuance of the stock.
- The stock must be held for more than five years.
- QSBS Exclusion is only available to non-corporate taxpayers.
- There cannot be significant redemptions of stock by the issuing corporation.
- The company must be a qualified trade or business other than the following:
  - Any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees;
  - Any banking, insurance, financing, leasing, investing or similar business;
  - Any farming business;
  - Any business involving the production or extraction of oil and gas subject to depletion;
  - Any business of operating a hotel, motel, restaurant, or similar business.

While this program has been around since 1993, in its early days, high corporate tax rates generally dissuaded companies from choosing the C corporation entity

structure and thus being eligible. However, the Tax Cuts and Jobs Act of 2017 lowered the corporate tax rate, making the QSBS exclusion more appealing for founders and investors alike. Evolving laws, especially those that affect C corps, will continue to be important factors in determining the future and usefulness of the QSBS program.

To discuss QSBS and the related opportunities it presents, contact [Brent Lessey](#), Tax Leader of Anchin's Consumer Products Group, or your Anchin Relationship Partner.