



Robert W. Wood

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Congress Targets \$10M Qualified Small Business Stock Tax Break

Earlier this year, Silicon Valley breathed a sigh of relief when the Biden administration made clear that despite other tax hikes, the Qualified Small Business Stock (QSBS) exclusion would be retained without change. But now, the Ways & Means Committee has proposed slashing QSBS benefits for high income persons. A proposed amendment would change section 1202(a) so the 75% and 100% exclusion rates for QSBS gains will not apply to taxpayers with adjusted gross income of \$400,000 or more. The baseline 50% exclusion would remain available for all taxpayers. The amendment will apply to sales and exchanges after September 13, 2021, subject to a binding contract exception.

A 50% exclusion on a \$10M stock gain is nothing to sneeze at, but it's hardly the same as 75% or 100%. In May, the Treasury Department's General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals, known as the "Green Book," said section 1202 was safe: "the exclusion under current law for [capital gain](#) on the certain small business stock would also [continue to] apply." But the need for revenue must have taken priority, so QSBS is in the crosshairs. The QSBS benefit is truly extraordinary. For the

small companies that qualify—generally up to \$50 million in assets—shareholders who have held their stock for 5 years may be able to exclude their gain from federal tax. The shareholder limit is usually \$10 million, and \$10 million tax free would be nice! If you sell QSBS but have not held it for 5 years, there is another QSBS benefit. You can defer the gain by rolling it over into a new investment in QSBS. All in all, the QSBS rules [can allow founders and other shareholders huge tax free or tax deferred](#) benefits.



The proposal is “Sec. 138150. Limitation on Certain Special Rules for Section 1202 Gains,” and here is a link to the proposal in the Ways and Means Committee: [Responsibly Funding Our Priorities Section-by-Section](#). The effective date says: “Except as provided in subsection (c), the amendment made by this section shall apply to sales and exchanges on or after September 13, 2021.” And the binding contract exception says: “The amendment made by this section shall not apply to any sale or exchange which is made pursuant to written binding contract which was in effect on September 12, 2021, and is not modified in any material respect thereafter.”

How any last minute sales will be treated could be an issue to watch. Section 1202(j) generally suspends the taxpayer’s holding period during any period in

which he holds an “offsetting short position” that reduces his exposure to the risk of price changes. According to Section 1202(j)(2), this includes a period during which the taxpayer holds an option to sell substantially identical property at a fixed price. The holding period is also suspended if there is any other transaction which substantially lessens the risk of loss, “to the extent provided in regulations.” Stay tuned.

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