

Qualified Small Business Stock (QSBS) Planning

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Tax Planning Practice

Scott Dolson and Frost Brown Todd's tax planning team have developed a national practice solving clients' qualified small business stock (QSBS) planning issues. FBT's QSBS expertise complements the firm's established start-up and closely-held business practices.

QSBS (Code Section 1202) Background

Under Code Section 1202, each founder and investor who sells QSBS and has met Section 1202's eligibility requirements can exclude at least \$10 million of gain from federal income taxation. Many states follow the federal treatment. A wide range of business activities qualify under Section 1202, including many software, biotechnology, pharma, retailing and manufacturing businesses. We assist clients who are deciding whether to operate through a C corporation (QSBS is stock of a domestic (US) C corporation), determining whether their business and stock has met Section 1202's eligibility requirements, and seeking assistance with trust and exit (M&A) planning.

Code Section 1045 Background

Code Section 1045 allows taxpayers who sell their original shares of QSBS prior to satisfying Section 1202's five-year holding period requirement to reinvest the sales proceeds on a pre-tax basis QSBS into replacement QSBS. Sales proceeds can be reinvested into third-party replacement QSBS (e.g., your typical preferred stock investments). The selling stockholder can also choose to fund a de novo start-up or acquire a qualified small business. We advise clients with respect to planning for and successfully implementing a Section 1045 reinvestment in replacement QSBS.

[Additional Code Section 1202 and 1045 articles](#) can be found on FBT's website.

Legislative Outlook

On September 13, 2021, proposed tax legislation came out of the House Ways and Means Committee that included a provision amending Section 1202(a) to provide that the current 100% QSBS gain exclusion rate would be reduced to 50% for taxpayers with adjusted gross income equal or exceeding \$400,000. This proposed amendment has stalled in the Senate, along with the rest of the Build Back Better tax and spending legislation. At this time, it is safe to say that there is no certainty that Section 1202's benefits will be cut back in the near future.

More About Our QSBS Work:

Our QSBS related work ranges across the entire spectrum of planning and implementation of tax and corporate work for early-stage and mature qualified small businesses. In that process, we work with corporations issuing QSBS, their founders and investors, and funds making and holding QSBS investments. Here is a nonexclusive list of typical QSBS projects:

- Assisting clients with respect to their choice of entity planning.
- Assisting client who are converting partnerships (LLC/LPs) to corporations.
- Handling the restructuring of S corporations, including focusing on Section 1202 planning and other tax and business benefits of operating through a C corporation with a holding company-subsidiary structure.
- Issuing written tax memoranda and opinions with respect to various QSBS issues.
- Advising founders, management teams and investors with respect to QSBS eligibility and documentation requirements.
- Handling the restructuring of businesses with an eye towards qualifying for Section 1202's benefits.
- Assisting clients with respect to the issuance of convertible debt, SAFEs, and common and preferred stock.
- Assisting clients with their equity compensation planning, including equity plans and grants.
- Advising founders and management teams in connection with M&A transactions, including the nuances of equity rollovers involving QSBS.
- Assisting companies with their QSBS-related communications with investors, including the making of representations and covenants supporting QSBS eligibility.
- Advising stockholders how to maximize their Section 1202 gain exclusion amounts.
- Helping to solve difficult Section 1202 eligibility issues.
- Assisting with trust planning and gifting of stock involving QSBS.
- Assisting clients with respect to all aspects of reinvesting QSBS sales proceeds into replacement QSBS under Section 1045.
- Advising clients with respect to documenting their eligibility for claiming Section 1202's gain exclusion, and successfully qualifying for electing to reinvest their QSBS proceeds under Section 1045 into replacement QSBS.
- Advising clients with respect to the interaction of carried interests and QSBS.
- Assisting investment funds and investors with respect to holding QSBS through LLCs/LPs.

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FBT's Tax Planning Team

In addition to FBT's national QSBS practice, the tax planning team assists clients and other FBT business attorneys with entity structuring, financing and M&A transactions. The team also functions as a “destination shop” for clients seeking specialized partnership, M&A, venture financing and state and local (SALT) tax planning assistance. The tax planning team includes the following attorneys:



[Scott Dolson](#) - Tax Planning team leader and co-chair of the firm's Private Equity industry team. Practice areas include tax planning, M&A, and outside general counsel.



[Marty Mooney](#) - Practice areas include tax planning with deep experience working with pass-thru entities.



[Melanie McCoy](#) - Team leader of the firm's Estates, Trusts and Wills team. Practice areas include estate planning and trust work.



[Laura Stapleton](#) - Practice areas include federal and state tax planning.



[Bethany Davenport](#) - Practice areas include gift and estate planning and federal tax planning.



[Bill Strench](#) - Practice areas include start-ups and venture capital financing.



[Kaitlin Hizny](#) - Practice areas include employee benefits and the Employee Retirement Income Security Act (ERISA).



[Raghav Agnihotri](#) - Practice areas include state and local, federal, and international tax planning.

About Frost Brown Todd: Frost Brown Todd is a regional law firm of over 500 attorneys spanning a nine-state footprint. Our [tax practice](#) works closely with businesses, founders and investors (spanning individuals, family offices and PE firms) to assist them in their efforts to qualify for Section 1202's generous tax benefits.

Check out our [blog](#) on all things Tax.