

Qualified Small Business Stock (QSBS)

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FBT's Tax Planning Practice

Frost Brown Todd LLP (FBT) is a full-service firm with approximately 575 lawyers in 12 states, including Pennsylvania, Ohio, Texas, California, Tennessee, Indiana and Kentucky.

Scott Dolson and FBT's tax planning team have developed a national practice solving clients' QSBS planning issues. FBT's tax planning team also focuses on issues unique to start-ups, closely-held businesses, equity compensation arrangements and M&A transactions. FBT's trust and estate attorneys work closely with the tax planning team on QSBS matters.

Section 1202 – Qualified Small Business Stock (QSBS)

Section 1202 generally provides for a \$10 million exclusion of gain from federal income taxes (and sometimes state income taxes) if stockholder sells QSBS after meeting all of Section 1202's stockholder and issuing corporation level eligibility requirements. Many states follow the federal treatment. A wide range of activities potentially qualify under Section 1202, including many software, biotechnology, pharma, retailing and manufacturing businesses.

Our work regularly includes advising clients when they are deciding whether to operate through a C corporation (QSBS is limited to stock of a US C corporation), making sure that M&A transactions are structured to maximize Section 1202's benefits, and assisting clients who need assistance determining whether stock is, in fact, QSBS.

Section 1045

Code Section 1045 allows taxpayers who sell their original shares of QSBS 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., typical offerings of preferred stock). The selling stockholder can also elect to fund a start-up creating a new activity or acquire a business already engaged in a qualified activity. Section 1045 is typically used in situations where a stockholder hasn't satisfied Section 1202's five year holding period requirement but can also be used to roll over any QSBS proceeds.

We help clients successfully undertake Section 1045 reinvestments in replacement QSBS.

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

More About Our QSBS Work:

Our QSBS practice is focused on maximizing the gain exclusion allowable under Section 1202 or successfully navigating Section 1045's requirements. An important part of our work involves making sure that our clients are eligible to claim

Section 1202's gain exclusion or election to reinvest proceeds under Section 1045. All key part of our QSBS work is making sure that our clients are in the best position possible if the IRS challenges their return positions. Our tax planning team works with the corporations issuing QSBS, their stockholders (founders and investors), pass-thru entities (LPs/LLCs) holding QSBS and their legal and accounting advisors. Here is a nonexclusive list of our tax planning team's typical QSBS projects:

- Assisting clients with respect to their choice of entity planning (e.g., should I operate my business through a C corporation?).
- Assisting client who are converting tax partnerships (LLC/LPs) to C corporations.
- Handling the restructuring of S corporations using Type F reorganizations, with the focus on QSBS planning and the other tax and non-tax benefits associated with operating through C corporations.
- Issuing written tax memoranda and opinions with respect to various QSBS issues, including the satisfaction of issuing-corporation and stockholder eligibility requirements associated with claiming Section 1202's gain exclusion.
- 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 intersection between Section 1202 and equity compensation planning, various types of equity and equity rights (e.g., restricted stock, convertible debt and SAFEs).
- Advising founders and management teams in connection with M&A transactions, including the nuances of equity rollovers involving QSBS.
- Assisting companies fashioning their QSBS-related communications with investors, including providing certificates or information copies of opinions
- Advising stockholders how to maximize their Section 1202 gain exclusion amounts.
- Dealing with difficult Section 1202 eligibility issues and associated planning.
- Assisting with trust planning for and gifting of QSBS.
- Assisting with all aspects of reinvesting QSBS sales proceeds into replacement QSBS under Section 1045.
- Advising clients with respect to documenting their QSBS-related return positions.
- Advising with respect to how carried interests and QSBS relate.
- Assisting investment funds and investors with planning for holding QSBS through pass-thru entities (LLCs/LPs).

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

Trust Planning:

FBT's estate and trust attorneys have developed significant expertise and experience working with clients in structuring the gifting and ownership of QSBS. In particular, FBT trust attorneys work with the tax planning group and a client's estate planning lawyers in structuring QSBS ownership arrangements using Delaware non-grantor trusts to achieve client's Section 1202, state tax, wealth transfer and asset protection goals.

Legislative Outlook:

An amendment to Section 1202 was included in the 2021 “Build Back Better” legislation. That legislation ultimately failed, and the Inflation Reduction Act passed during August, 2022, did not include changes to Sections 1202 or 1045. Although it is always dangerous to predict what Congress will do next, it seems reasonable given our divided government to assume for planning purposes that the benefits of QSBS will remain available for the foreseeable future.

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, equity compensation planning, start-ups and venture capital 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.



[Brian Masterson](#) - Practice areas include federal, state and local tax planning and mergers and acquisitions.



[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 national law firm of over 575 attorneys spanning an 12-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.