DAHL
LAW GROUP

GUIDE 1

A BUSINESS OWNER'S GUIDE TO QUALIFIED SMALL BUSINESS STOCK

COULD THE WAY YOU STRUCTURE YOUR BUSINESS TODAY SAVE YOU MILLIONS WHEN YOU SELL?



WHY QSBS MATTERS

THE FINANCIAL DIFFERENCE CAN BE SIGNIFICANT

Imagine you eventually sell qualifying stock and recognize $10 million of gain. For certain QSBS acquired after July 4, 2025, the holding period can dramatically change how much of that gain may qualify for the federal exclusion.

3 YEARS



50%
POTENTIAL EXCLUSION

UP TO **$5M** OF GAIN

4 YEARS



75%
POTENTIAL EXCLUSION

UP TO **$7.5M** OF GAIN

5+ YEARS



100%
POTENTIAL EXCLUSION

UP TO **$10M** OF GAIN

WHAT THIS MEANS FOR YOU

A few years of planning can potentially affect millions of dollars of taxable gain. But simply owning stock in a successful company is not enough. The stock, company and shareholder must satisfy a series of requirements, and those requirements do not all arise on the day you sell.

CALIFORNIA NOTE

QSBS is a federal tax benefit. California currently does not conform to the federal gain exclusion under IRC §1202, so qualifying for the federal exclusion does not necessarily eliminate California tax on the gain.

ALSO IMPORTANT

For post-July 4, 2025 qualifying stock, the fixed-dollar federal exclusion limit increased to $15 million (subject to the statute and future inflation adjustments), with a separate 10x-basis alternative.

Sources: 26 U.S.C. §1202; IRS Schedule D Instructions (2025); California FTB Schedule D (540) Instructions (2025).

DECISION 1

YOUR ENTITY CHOICE CAN START OR DELAY THE QSBS OPPORTUNITY

THE QUESTION

What type of company is issuing your ownership interest?

DOMESTIC C CORPORATION

QUALIFYING STOCK

Holding-period clock can begin

OTHER INTEREST

Not itself QSBS

QSBS generally must be stock in a domestic C corporation. An ownership interest in an LLC, partnership or S corporation is not itself QSBS.

Later conversions, reorganizations and exchanges can have specialized rules and require separate analysis.

If qualifying C-corporation stock is issued, that stock may begin building toward the applicable QSBS holding period. If years of value are built in another structure first, do not assume those earlier years automatically count toward the QSBS holding period.

POTENTIAL BENEFIT

Starting the qualifying-stock clock earlier can preserve more time to reach a higher exclusion tier.

POTENTIAL CONSEQUENCE

Waiting too long to create qualifying stock can leave earlier years of growth outside the QSBS timeline.

WHAT THIS MEANS FOR YOU

The planning question is not simply “C corporation or LLC?” It is: “If I may eventually sell, how does my entity choice today affect my tax options later?”

Sources: 26 U.S.C. §1202(c), (d); IRS Schedule D Instructions (2025).

DECISION 2

HOW YOU RECEIVE YOUR SHARES CAN CHANGE THE RESULT

Two people can own stock in the same company and have different QSBS outcomes because the history of each block of shares matters.

POTENTIALLY QUALIFYING PATH



CORPORATION





YOU RECEIVE NEW SHARES

GENERALLY DIFFERENT RESULT



EXISTING SHAREHOLDER





YOU BUY EXISTING SHARES

THE TECHNICAL RULE

Core rule: QSBS generally must have been originally issued after August 10, 1993, and acquired at original issuance in exchange for money, qualifying property or services. Special rules can apply to certain gifts, inheritances, conversions and exchanges.

Why capital raises matter. A company can have multiple blocks of stock with different tax histories. One financing round may be structured correctly while another is not. The issuance mechanics of one round can affect QSBS treatment for that block even if other issuances have different results.

WHAT THIS MEANS FOR YOU

Do not stop at "Does my company qualify for QSBS?" Ask the more precise question: "Does this particular block of stock qualify?" Review that question whenever new stock is issued.

DIRECT ISSUANCE • EACH ROUND MATTERS • STOCK HISTORY MATTERS

Sources: 26 U.S.C. §1202(c); IRS Schedule D Instructions (2025); Dahl Law Group QSBS webinar materials.

DECISION 3

WAITING UNTIL THE COMPANY IS TOO LARGE CAN CLOSE THE WINDOW

QSBS was designed for investment in smaller businesses, so the law imposes a gross-asset test when qualifying stock is issued.

STOCK ISSUED ON OR BEFORE JULY 4, 2025

$50M

GENERAL GROSS-ASSET THRESHOLD

STOCK ISSUED AFTER JULY 4, 2025

$75M

GENERAL GROSS-ASSET THRESHOLD

THE TEST IS ABOUT TIMING

BEFORE
within limit during relevant period

→

ISSUANCE
new shares issued

→

AFTER
within limit immediately after

The company generally must remain within the applicable gross-asset threshold during the relevant statutory period before the issuance and immediately after the shares are issued. Gross assets include cash and the adjusted basis of other property, with additional rules for predecessor and controlled corporations.

POTENTIAL BENEFIT

Stock properly issued while the corporation satisfies the test may retain a different QSBs history even if the company grows beyond the threshold later.

POTENTIAL CONSEQUENCE

If the company grows beyond the applicable threshold before new stock is issued, future shares may fail this requirement.

WHAT THIS MEANS FOR YOU

Growth is good, but rapid growth can make timing more important. If the company is approaching the applicable limit, review a capital raise, restructuring or stock issuance before it closes.

Sources: 26 U.S.C. §1202(d); IRS Schedule D Instructions (2025). $75M threshold is indexed for taxable years beginning after 2026.

DECISION 4

WHAT YOUR COMPANY DOES CAN AFFECT WHETHER STOCK STAYS QUALIFIED

Getting the structure right on day one is not enough. During substantially all of the applicable holding period, the corporation generally must use at least 80% of the value of its assets in the active conduct of one or more qualifying businesses.



80%
ACTIVE-BUSINESS TEST

COMMON EXCLUDED CATEGORIES INCLUDE



Health, law, engineering, architecture, accounting and actuarial science



Consulting, athletics, performing arts and certain skill/reputation businesses



Banking, insurance, financing, leasing, investing and brokerage



Farming; certain extraction businesses; hotels, motels and restaurants

THE RISK IS NOT ONLY AT FORMATION



QUALIFYING ACTIVITY →  **BUSINESS PIVOT** →  **QSBS RISK**

A company can begin with qualifying activities and later change. If it moves significantly into excluded activities or accumulates excessive nonbusiness assets, stock that was originally on the right path can face QSBS risk.



POTENTIAL BENEFIT

Maintaining a qualifying active business and appropriately deployed assets can help preserve the opportunity.



POTENTIAL CONSEQUENCE

A major pivot, acquisition or change in asset use can create a QSBS problem even years after the stock was issued.



WHAT THIS MEANS FOR YOU

Before a major change in what the company does, ask: "Could this change affect our QSBS position?"

Sources: 26 U.S.C. §1202(e); IRS Schedule D Instructions (2025); Dahl Law Group QSBS webinar materials.

DECISION 5

ONE MORE YEAR OF OWNERSHIP CAN MAKE A VERY BIG DIFFERENCE

For certain qualifying stock acquired after July 4, 2025, the federal exclusion now rises in steps. That can make the timing of a sale financially meaningful.



IF YOU HAVE $10 MILLION OF QUALIFYING GAIN

3 YEARS TO UNDER 4 YEARS

$5M potentially excluded

4 YEARS TO UNDER 5 YEARS

$7.5M potentially excluded

5 YEARS OR MORE

$10M potentially excluded

These figures show potentially excluded gain, not guaranteed tax savings, and assume the stock satisfies the other §1202 requirements and remains within the applicable exclusion limit.

WHAT THIS MEANS FOR YOU

If an attractive offer arrives close to the next holding-period threshold, the sale price is not the only number that matters. Model the tax difference before deciding whether to close this year or next year.

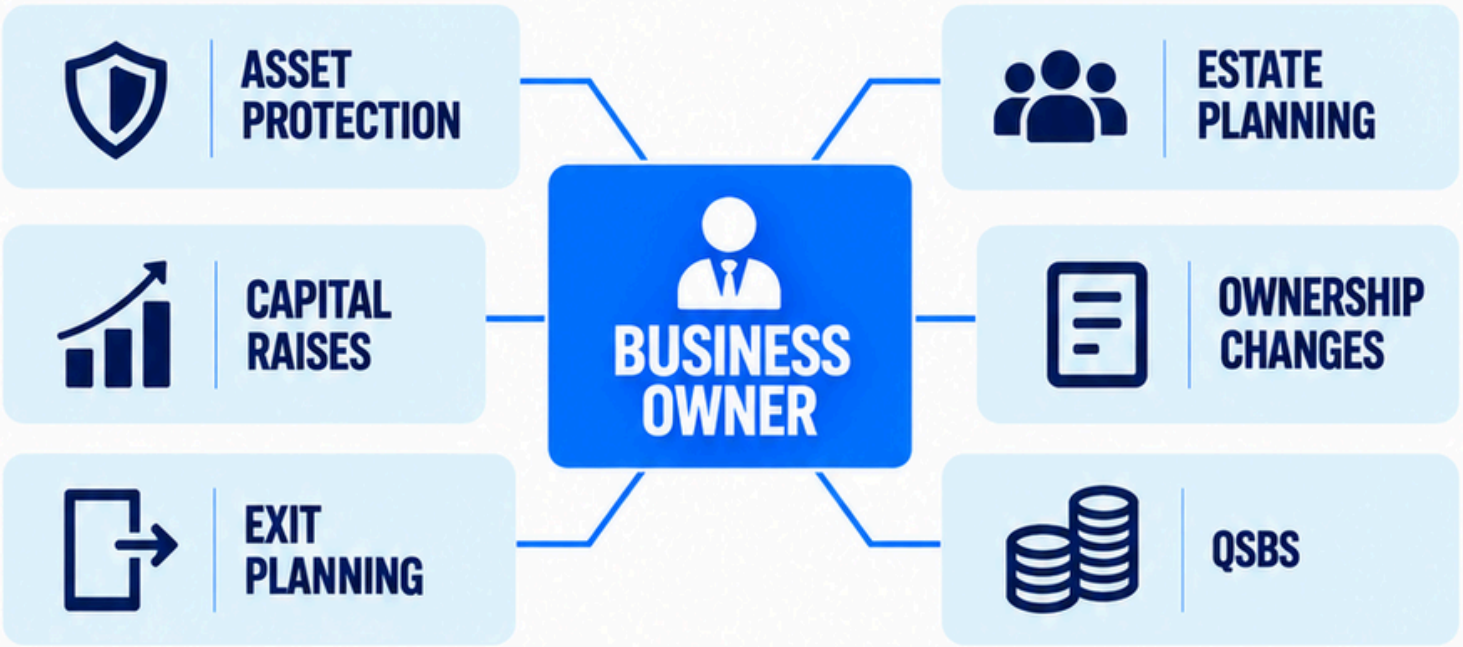
"WHAT HAPPENS IF WE CLOSE THIS YEAR INSTEAD OF NEXT YEAR?"

Source: 26 U.S.C. §1202(a), (b). Illustrative $10M gain example only; actual tax consequences depend on individual facts.

INTEGRATED PLANNING

A DECISION THAT HELPS ONE PART OF YOUR PLAN CAN HURT ANOTHER

Business owners rarely make decisions for tax reasons alone. The challenge is that a move designed to solve one issue can create an unintended QSBS consequence somewhere else.



ONE DECISION • MULTIPLE CONSEQUENCES

Changing how stock is held after it has already been issued can produce a different result from having the ownership structure in place when the corporation originally issues the stock. The original-issuance and pass-through rules make the sequence of events important.

POTENTIAL BENEFIT

Coordinating tax, estate, asset-protection and exit planning lets you evaluate the QSBS consequence before acting.

POTENTIAL CONSEQUENCE

A transfer or restructuring can make sense for one goal while unintentionally damaging a valuable tax opportunity.

WHAT THIS MEANS FOR YOU

Before changing who owns your shares or how they are held, add one question to the agenda: “What does this do to my QSBS?”

Sources: 26 U.S.C. §1202(c), (h); Dahl Law Group QSBS webinar materials.

PRACTICAL CHECKLIST

KNOW WHEN TO STOP AND ASK ABOUT QSBS

You do not need to memorize IRC §1202. You do need to recognize the moments when a business decision deserves a QSBS review.

1 

FORMING OR RESTRUCTURING

Could our entity choice affect a future QSBS opportunity?

2 

ISSUING NEW STOCK

Is the corporation within the applicable gross-asset threshold, and is the issuance structured correctly?

3 

RAISING CAPITAL

Will the financing change gross assets or how new shares are issued?

4 

CHANGING THE BUSINESS MODEL

Could the new activity fall into an excluded category or affect the 80% test?

5 

TRANSFERRING STOCK

Could moving shares into an LLC, partnership, trust or another structure change the analysis?

6 

ACCEPTING AN OFFER TO SELL

Exactly how long have I held the stock, and would a different closing date materially change the potential exclusion?



AND THROUGHOUT THE PROCESS: CAN YOU PROVE WHAT HAPPENED?

QSBS eligibility may need to be documented years after stock was issued. Preserve corporate records, capitalization records, issuance documents, financial information and ownership history.

Sources: 26 U.S.C. §1202; IRS Schedule D Instructions (2025); Dahl Law Group QSBS webinar transcript and materials.

THE BIGGEST QSBS MISTAKE MAY BE WAITING UNTIL YOU ARE READY TO SELL

QSBS PLANNING IS REALLY ABOUT PRESERVING OPTIONS

The decisions you make early — how your business is structured, how stock is issued, and how you plan for growth — can have a major impact on whether you can take advantage of the QSBS exclusion when you sell.

FIVE QUESTIONS TO REVIEW EARLY

1. Is qualifying C-corporation stock being issued?
2. Am I receiving the shares in a way that can satisfy the original-issuance rules?
3. Is the company within the applicable gross-asset limit?
4. Is the company conducting a qualifying active business?
5. How long will I have held the shares when I sell?

THE EARLIER YOU ASK, THE MORE OPTIONS YOU MAY HAVE.

BOOK YOUR STRATEGY SESSION

If a future sale is part of your business plan, Dahl Law Group can help evaluate how your entity structure, stock ownership, tax planning and exit strategy work together.

SCAN TO SCHEDULE

DISCLAIMER

Educational material only; not legal, tax, accounting, investment or financial advice. IRC §1202 is highly technical and fact-specific. California does not currently conform to the federal §1202 gain exclusion. Applicable law may change.