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Changes to IRC Section 1202 Under the "One Big Beautiful Bill Act"

Critical changes to Internal Revenue Code ("IRC") Section 1202 pertaining to the exclusion of gain from the sale of stock of a domestic C corporation that is Qualified Small Business Stock ("QSBS"), as enacted by the "One Big Beautiful Bill Act" ("OBBBA"), which recently passed Congress and was signed into law by President Trump on July 4, significantly expand the benefits available to founders and investors in qualified small businesses.

These changes are designed to further incentivize investment in American startups and growth-oriented companies. We encourage you to review these updates carefully as they may present new opportunities for tax savings.

The OBBBA introduces three primary modifications to IRC Section 1202, effective for QSBS acquired on or after the date of enactment:

Modified Holding Period for Gain Exclusion:

Prior Law: To qualify for the 100% gain exclusion, QSBS generally needed to be held for more than five years.

New Law: The OBBBA introduces a tiered exclusion system based on holding period:

- 50% exclusion for QSBS held for at least three years.
- 75% exclusion for QSBS held for at least four years.
- 100% exclusion for QSBS held for at least five years.

This change will provide earlier access to QSBS benefits, enhancing liquidity and flexibility for founders and investors.

Increased Gain Exclusion Cap:

Prior Law: The maximum gain a taxpayer could exclude was generally limited to the greater of $10 million or 10 times the aggregate adjusted basis of the QSBS.

New Law: The per-taxpayer, per-issuer gain exclusion cap has been increased to $15 million, or 10 times the aggregate adjusted basis of the QSBS, whichever is greater.

Beginning in 2027, this $15 million cap will be indexed for inflation, providing even greater potential tax savings over time.

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Increased Aggregate Gross Assets Threshold:

Prior Law: A domestic C corporation generally qualified as a small business if its "aggregate gross assets" (cash and tax basis in assets) did not exceed $50 million immediately before and after the issuance of the QSBS.

New Law: The aggregate gross assets cap has been raised to $75 million.

Similar to the gain exclusion cap, this $75 million threshold will also be indexed for inflation starting in 2027. This expansion makes a broader range of companies eligible to issue QSBS, increasing investment opportunities.

Important Considerations:

Effective Date: These changes generally apply to QSBS issued or acquired on or after the date of enactment of the OBBBA (i.e., July 4, 2025). There may be forthcoming guidance from the Internal Revenue Service and/or Treasury Department regarding provisions of the OBBBA, including changes to IRC 1202.

Domestic C Corporations: The QSBS provisions continue to apply only to stock issued by domestic C corporations that meet the specified asset limitations and active business requirements.

This memorandum is to provide an overview of changes to IRC 1202 enacted by the OBBBA and its impact. It is for general information purposes only and should not be considered or relied on as a legal opinion of Kutak Rock LLP.

If you have questions, please contact any member of Kutak Rock's National Tax Practice Group. You may also visit us at www.kutakrock.com.