

M&A Nugget: Qualified Small Business Stock Update

January 22, 2026

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In 1993, Congress passed a tax law intended to incentivize entrepreneurs to invest in early-stage companies. This tax law, often referred to as QSBS (Qualified Small Business Stock) allows stockholders to exclude from tax a substantial portion of the gain on certain business sales structured as stock sales. Last year, the law was amended to expand tax savings.

Here is how the QSBS tax exemption works:

- If a stockholder holds shares of stock issued initially and currently held in a C corporation, and
- The shares of stock have been owned for at least three years, and
- The corporation has assets of less than \$50M or \$75M (depending on the year the stock was acquired), and
- At least 80% in value of the corporation's assets are used in the active conduct of a "qualified trade or business", then
- When stock is sold in a business sale, between 50% and 100% of the gain can be excluded from tax.

A “qualified trade or business” means any trade or business, except certain service businesses (usually involving the rendering of professional services), banking and insurance businesses, and certain real estate-related businesses.

The most significant change in 2025's QSBS amendment was to increase the amount of gain that can be excluded from tax. For stock issued before July 4, 2025, the maximum exclusion is \$10M. For stock issued on or after July 4, 2025, the maximum exclusion increases to \$15M.

The tax savings can be substantial. For example, on the sale of a business in a stock transaction for \$20M, if the original ownership was acquired before July 4, 2025, \$10M can be excluded from federal tax (as long as the stock was held for at least five years), resulting in tax savings in excess of \$2M.

Planning Opportunity

A stockholder that is not a corporation is eligible for the QSBS. This includes individuals and trusts and presents an extraordinary planning opportunity for an individual to create a trust to hold a portion of the company's ownership. If the trust is structured as a separate taxpayer, the individual and the trust can each take advantage of the QSBS tax exemption.

Many strict requirements must be satisfied to qualify for the QSBS, and anyone considering use of this tax law should engage a professional advisor who has experience with those requirements.