BFKN Alert: Proposal to Limit the Qualified Small Business Stock Tax Exemption

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On September 13, 2021, the House Ways and Means Committee released proposed tax legislation as part of the larger budget proposal. Among the proposed tax legislation is a limitation of the qualified small business stock ("**QSBS**") gain exclusion available under Section 1202 of the Internal Revenue Code of 1986, as amended (the "**Code**"), which would impact certain taxpayers. This proposed legislation, if enacted, would be effective for sales and exchanges of QSBS that occur on or after September 13, 2021, subject to a binding contract exception.

By way of background, Section 1202(a) of the Code enables non-corporate taxpayers (*e.g.*, individuals, trusts, estates, etc.) to exclude from gross income a portion of the capital gain on the sale of QSBS that is held for more than five years. Under current law, the amount of gain excluded on the sale of QSBS depends on when the stock was acquired, subject to applicable dollar limitations. The eligible gain exclusion percentage is:

- 50% for stock acquired after August 10, 1993 and before February 18, 2009.
- 75% for stock acquired after February 17, 2009 and before September 28, 2010.
- 100% for stock acquired after September 27, 2010.

Gain that is eligible for the exclusion but is not excluded after applying the abovementioned percentages is subject to tax at a 28% rate.

The current proposal would amend Section 1202(a) of the Code to eliminate the 75% and 100% gain exclusions for any taxpayer whose adjusted gross income equals or exceeds $400,000. In addition, trusts and estates would no longer qualify for either the 75% or 100% exclusion irrespective of income level. However, the 50% exclusion would remain for all taxpayers.

Clients currently holding QSBS, considering a sale of QSBS, or making choice of entity and other company structuring decisions should be aware of this potential change in tax law (with retroactive effect) as such a change could impact planning considerations.