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QUEUING-UP QUANTUM QSBS EXCLUSIONS

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OBuBBA!

SUMMARY OF OBBBA CHANGES TO SECTION 1202			
BEFORE OBBBA	**AFTER OBBBA**		
"Eligible Gain" and "Applicable Percentage" (Exclusion Percentage)			
5 Years	3 Years	4 Years	5 Years
100%	50%	75%	100%
"Applicable Dollar Limit" (Per-Taxpayer Limitation)			
$10 million per taxpayer	$15 million per taxpayer (plus inflation)		
Aggregate Gross Asset Requirement			
$50 million	$75 million (plus inflation)		

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Exclusion Percentage Depends on Acquisition Date

Acquisition Date	Exclusion Percentage	Maximum QSBS Rate	Maximum QSBS AMT Rate	Maximum Rate (No QSBS)
Aug. 11, 1993 to Feb. 17, 2009	50%	15.90%	16.88%	23.80%
Feb. 18, 2009 to Sep. 27, 2010	75%	7.95%	9.42%	23.80%
Sep. 28, 2010 to July 4, 2025	100%	0.00%	0.00%	23.80%
After July 4, 2025	(50%) 3-Year (75%) 4-Year (100%) 5-Year	15.90% 7.95% 0.00%	15.90% 7.95% 0.00%	23.80%

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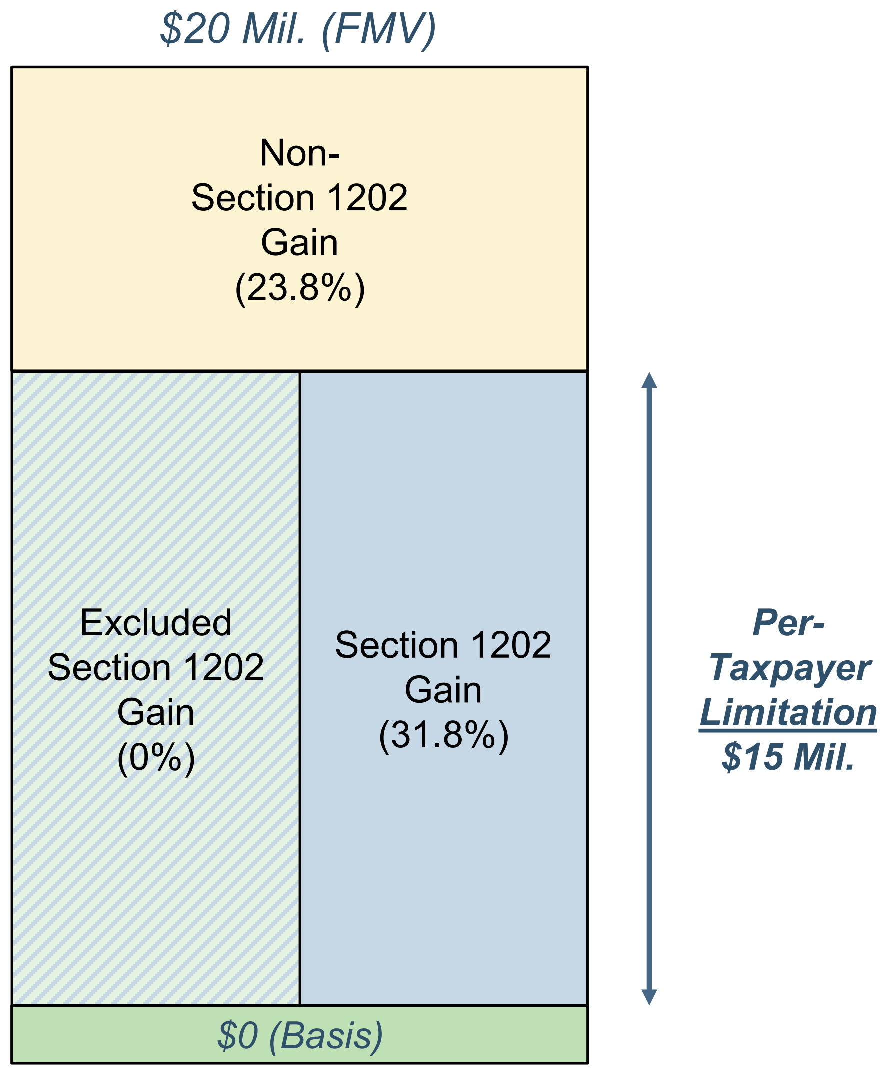
Calculating the Tax on the Sale of QSBS: Reminder



Calculating the Taxes: Comparison Example

A comparison of a founder selling founders shares of QSBS ($0 basis) issued at different times with different holding periods for $20 million.

	No QSBS	5-Year Hold Acquired 9/27/10 – 7/4/25	3-Year Hold Acquired Post-7/4/25	4-Year Hold Acquired Post-7/4/25	5-Year Hold Acquired Post-7/4/25
Gain	$20,000,000	$20,000,000	$20,000,000	$20,000,000	$20,000,000
Excluded	($0)	($10,000,000)	($7,500,000)	($11,250,000)	($15,000,000)
Taxable Gain	$20,000,000	$10,000,000	$12,500,000	$8,750,000	$5,000,000
Non-Section 1202 Gain (23.8%)	$20,000,000 ($4,760,000)	$10,000,000 ($2,380,000)	$5,000,000 ($1,190,000)	$5,000,000 ($1,190,000)	$5,000,000 ($1,190,000)
Section 1202 Gain (31.8%)	$0	$0	$7,500,000 ($2,385,000)	$3,750,000 ($1,192,500)	$0
Total Taxes	**($4,760,000)**	**($2,380,000)**	**($3,575,000)**	**($2,382,500)**	**($1,190,000)**
Net After Taxes	**$15,240,000**	**$17,620,000**	**$16,425,000**	**$17,617,500**	**$18,810,000**

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QSBS: 25 Years to Graduate… 7 Years to Mature…

RRA ‘93 · *TRA ‘97* · *IRRA ‘98* · *JGTRRA ‘03* · *ARRA ‘09* · *HCERA ‘10* · *SBJA ‘10* · *ATRA ‘12* · *PATHA ‘15* · *TCJA ‘17* · ***OBBBA ‘25***

1993 · *1998* · *2003* · *2008* · *2013* · *2018* · *2023* · *2028*

LTCG: 28% → **LTCG: 15%** → **LTCG: 23.8%**

§ 1202 (QSBS) Enacted 50% Exclusion

Acquired
8/11/93 to 2/17/09

→ QSBS Rate: 14% AMT QSBS Rate: 19.9%, then 17.9%
→ QSBS Rate: 14% AMT QSBS Rate: 14.98%
→ QSBS Rate: 15.9% AMT QSBS Rate: 16.88%
→ **3 Years 50% Exclusion QSBS Rate 15.9%**

QSBS 75% Exclusion

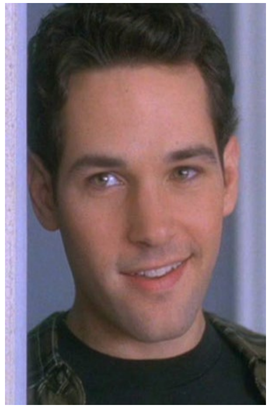
Acquired:
2/18/09 to 9/27/10

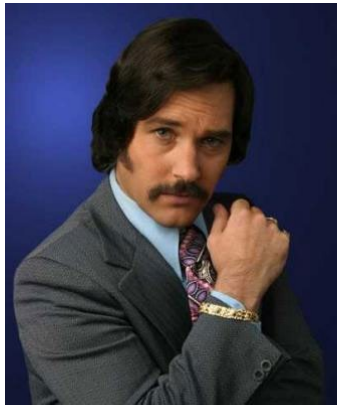
→ QSBS Rate: 7.95% AMT Rate: 9.42%
→ **4 Years 75% Exclusion QSBS Rate 7.95%**

QSBS 100% Exclusion

Acquired:
After 9/27/10

→ QSBS Rate: 0% AMT Rate: 0%
→ **5 Years 100% Exclusion QSBS Rate 0%**


“Clueless”


60% = Every Time


Superhero

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QSBS: Look Ma, I'm a Big Boy Now…!!

TCJA '17

OBBBA '25

2018 *2023* *2028* *2033* *2038*

C Corporation Tax Rate of 21%

§ 199A 20% Deduction
QBI of "Pass-Thru" Entities
(37% to 29.6%?)

80/60/40/20%
(2023-2026)

§ 168(k)
100%
Expensing

§ 1400Z
Qualified Opportunity Zone
(Deferral/Reduction/Exclusion)

§ 1400Z
Qualified Opportunity Zone
(Deferral/Reduction/Exclusion)

Aggregate Gross Asset Requirement

$75,000,000
+
Inflation

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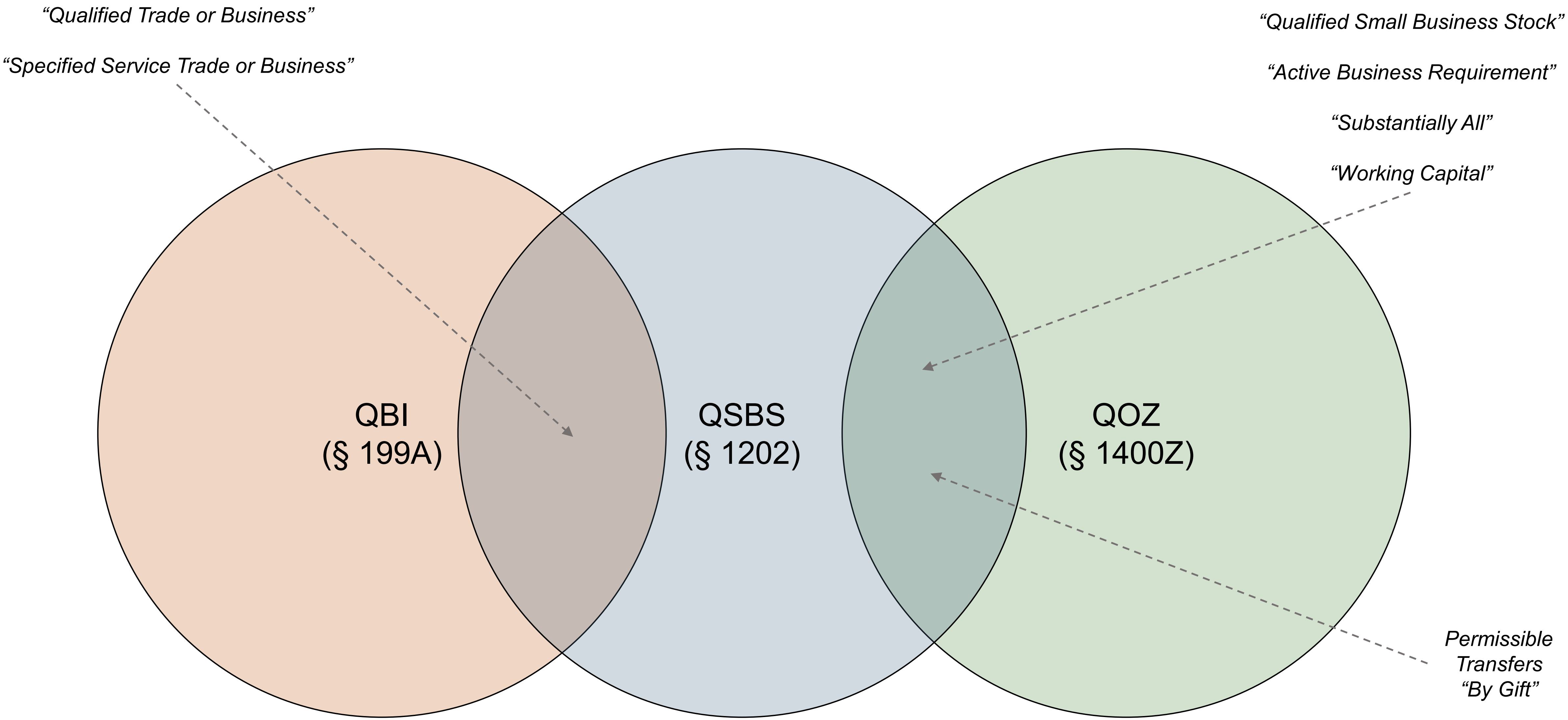
QSBS Venn Diagram: Guidance When Very Little Exists (Now)



Brilliant Concept… Executed Terribly: "Acquisition Date"

New § 1202(a)(6)(B) defines "**acquisition date**" as:

In the case of any stock which would (but for this paragraph) be treated as having been acquired ***before, on, or after*** the applicable date, whichever is applicable, the acquisition date for purposes of this section shall be the first day on which such stock was held by the taxpayer ***determined after the application of section 1223***.

<u>Why Section 1223???</u>

- **§ 351 tax-free exchange**
- **Carryover holding period?**
- **Same "flush" language in § 1202(a)(3) and § 1202(a)(4), added later in 2012**

"In the case where the taxpayer transfers property (other than money or stock) to a corporation in exchange for stock in such corporation, such stock shall be treated as having been acquired by the taxpayer on the date of such exchange."

§ 1202(i)(1)(A).

(§ 1223)
2019 holding period

Contributing Shareholders

C Corporation

(Property Purchased in 2019)

<u>Legislative History</u>

- Flush language only applies for purposes of the section 1045 rollover.
- "The provision is not intended to change the acquisition date determined under Section 1202(i)(1)(A) for certain stock exchanged for property."

Brilliant Concept… Executed Terribly: Inflation Adjustments

New **§ 1202(b)(5)(A)** provides an inflation adjustment:

"In the case of **any taxable year beginning after 2026**, the $15,000,000 amount … shall be increased by an amount equal to –

- Such dollar amount, multiplied by
- The cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year **2025'** for 'calendar year 2016' in subparagraph (A)(ii) thereof."

""[T]he proposal increases the per-issuer dollar cap to $15 million for post-enactment shares, indexed to inflation beginning in 2027."
Senate Finance Committee Explanation

New **§ 1202(d)(4)** provides an inflation adjustment:

"In the case of **any taxable year beginning after 2026**, the $75,000,000 amount … shall be increased by an amount equal to –

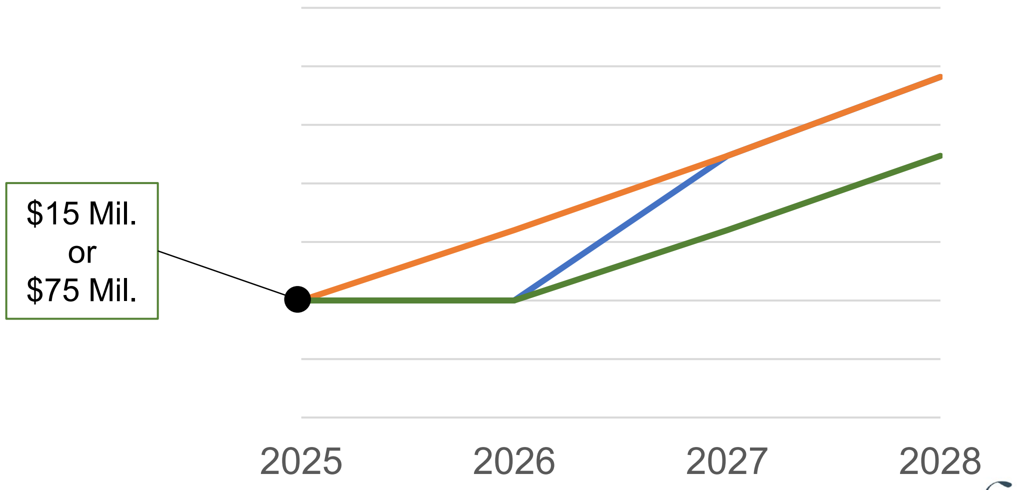
- Such dollar amount, multiplied by
- The cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year **2025'** for 'calendar year 2016' in subparagraph (A)(ii) thereof."

"For stock issued after the applicable date, the corporate-level aggregate-asset ceiling is increased to $75 million, indexed to inflation beginning in 2027."
Senate Finance Committee Explanation

Does it mean?

- **No inflation adjustment in 2026, but starting in 2027, the inflation adjustment to the Per-Taxpayer Limitation will be increased from $15 million to a number that includes the aggregate amount of inflation adjustments for calendar years 2025 and 2026 (a 2-year inflation adjustment);**
- **A 1-year inflation adjustment calculated from the beginning of 2025 that would be effective at the beginning of 2026; or**
- **No inflation adjustment in 2026 but providing a 1-year inflation adjustment calculated from the beginning of 2026 that would be effective at the beginning of 2027**

OBBBA mistakenly made the amendment to "§ 1202(b)" but it should be to "§ 1202(d)"



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Brilliant Concept… Executed Terribly: No Increase Once Exhausted

New **§ 1202(b)(5)(B)** provides:

"**No Increase Once Limit Reached** — If, for any taxable year, the eligible gain attributable to dispositions of stock issued by a corporation and acquired by the taxpayer after the applicable date ***exceeds*** the applicable dollar limit, then notwithstanding any increase under subparagraph (A) for any subsequent taxable year, the applicable dollar limit for such subsequent taxable year shall be **zero**."

As written, it results in an Applicable Dollar Limit of zero *only if* eligible gain for the year *exceeds* the Applicable Dollar Limit, and more importantly, the inflation adjustment provision is not clearly tied to the balance of the Additional Dollar Limit at the end of each taxable year.

It refers specifically to $15,000,000.

In other words, a taxpayer could realize just enough eligible gain each year, leaving a small balance of Applicable Dollar Limit (e.g., $100), and claim to get the inflation-adjustment based on $15 million starting from 2026.

Example

- Assume Applicable Dollar Limit is $20 Mil. for 2037.
- Taxpayer sells $18 Mil. of QSBS (90%).
- Taxpayer has $2 Mil. of Applicable Dollar Limit remaining.
- Cost-of-Living increase for 2037 is 5% ($1 Mil. if based on $20 Mil. or $100,000 if based on $2 Mil.).
- As written, taxpayer will have an Applicable Dollar Limit of $3 Mil. In 2038.
- Shouldn't it be $2.1 Mil.?

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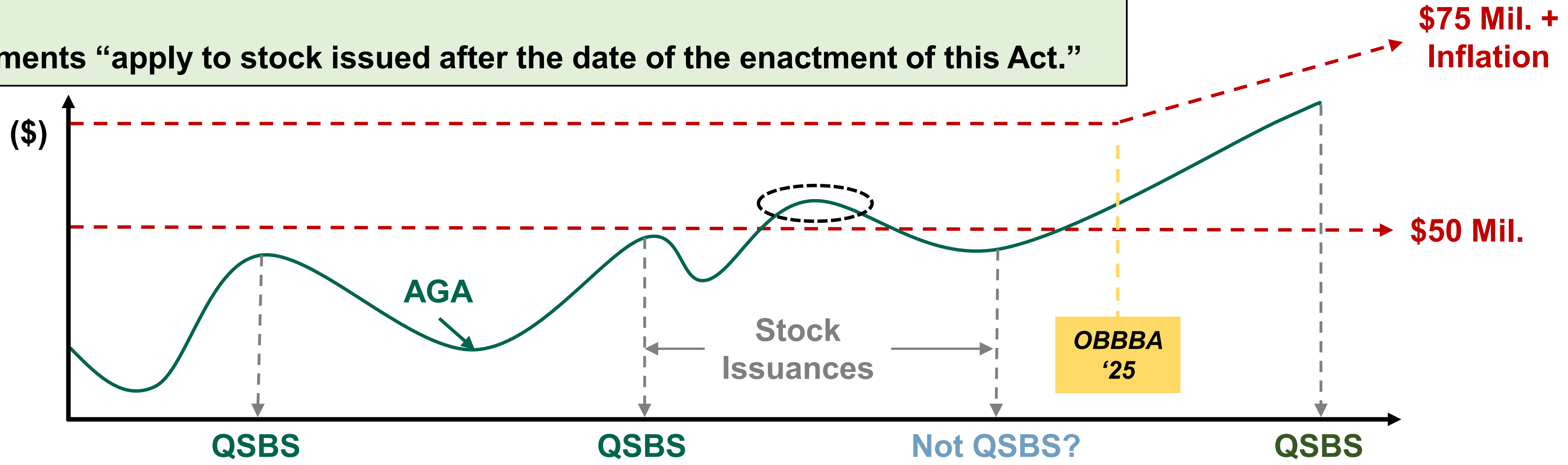
Aggregate Gross Asset Requirement Is RETROACTIVE

Amended **§ 1202(d)(1)** now provides: A QSB means any domestic C corporation if:

- "[T]he aggregate gross assets of such corporation (or any predecessor thereof) **at all times** on or after **the date of the enactment of the Revenue Reconciliation Act of 1993** and before the issuance did not exceed **$75,000,000**,
- [T]he aggregate gross assets of such corporation immediately after the issuance (determined by taking into account amounts received in the issuance) do not exceed **$75,000,000**, and
- [S]uch corporation agrees to submit such reports to the Secretary and to shareholders as the Secretary may require to carry out the purposes of this section."

As amended, this can have a <u>RETROACTIVE</u> effect

- **The "at all times" is tied to initial enactment in 1993 but now tied to the $75,000,000 cap.**
- **But the amendments "apply to stock issued after the date of the enactment of this Act."**



Applicable Dollar Limit: Per-Issuer and Per-Taxpayer Limitations

Amended **§ 1202(b)(1)** now provides:

"If the taxpayer has eligible gain for the taxable year from 1 or more dispositions of stock issued by any corporation, the aggregate amount of such gain from dispositions of stock issued by such corporation which may be taken into account … for the taxable year shall not exceed the greater of—"

- The "**applicable dollar limit**" for the taxable year, and
- 10 times the aggregate adjusted bases of qualified small business stock issued by such corporation and disposed of by the taxpayer during the taxable year."

New **§ 1202(b)(4)** provides the **applicable dollar limit** is:

If the QSB stock was acquired on or before the applicable date (July 4, 2025), "**$10,000,000** reduced by the aggregate amount of eligible gain taken into account by the taxpayer … for prior taxable years and attributable to dispositions of stock issued by such corporation.

If the QSB stock was acquired after the applicable date (July 4, 2025), **$15,000,000**, reduced by the sum of:

- "[T]he aggregate amount of eligible gain taken into account by the taxpayer … for prior taxable years and attributable to dispositions of stock issued by such corporation and acquired by the **taxpayer before, on, or after** the applicable date, plus;"
- "[T]he aggregate amount of eligible gain taken into account by the taxpayer … for the taxable year and attributable to dispositions of stock issued by such corporation and acquired by the taxpayer **on or before** the applicable date."

- **QSB corporations that existed prior to the enactment of OBBBA could issue QSB stock after July 4, 2025, and taxpayers who acquired QSB stock under the old rules, which are then sold, will be limited to $10 million of Per-Taxpayer Limitation.**
- **If QSB shares acquired after July 4, 2025 are subsequently sold, then sales of shares (in previous years and the current year) acquired under the old rules would be taken into account for purposes of the taxpayer's Per-Taxpayer Limitation of $15 million.**
- **Taxpayers cannot "double dip" hoping to get $10 million of exclusion for the old shares & $15 million of exclusion for the new shares.**

Important Other Changes Affecting QSBS Planning

New **§ 174A**:

- Permanently repeals the capitalization regime for **domestic** Research and Experimental (R&E) expenditures incurred in tax years beginning after December 31, 2024, allowing for the immediate deduction of the expenses.
- Includes domestic software development costs (including salaries of the developers).
- All taxpayers may elect to deduct unamortized balance of capitalized domestic R&E in the first year beginning after December 31, 2024, or ratably over the 2-year period beginning after December 31, 2024.
- Eligible "small businesses" (gross receipts of less than $31 million) may elect to adopt the changes affecting R&E expenditures **retroactively** in tax years beginning after December 31, 2021.

Reinstatement of 100% "bonus depreciation" under **§ 168(k)**:

- Qualified property acquired after January 19, 2025, in the year it was placed into service
- Qualified property includes MACRS property with a recovery period of 20 years or less

Aggregate Gross Assets means:

- **Amount of cash, plus**
- **Aggregate *adjusted bases* of other property held by the corporation (but not contributed to the corporation), plus**
- ***Fair market value* of contributed property *on the date of contribution*.**
- **Does not include liabilities.**

"Packing" the 10 Times Basis Limitation

Packing (Maximizing) the 10 Times Basis Limitation with Contributions of Property

$40 Mil. Built-In Gain
$10 Mil. (Basis)

X 10 = $500 Million Per-Issuer Limitation

Goodwill
Includes name, brand, and customer relationships

Packing the 10 Times Basis Limitation with Non-Eligible Gain

10 Times Basis Limitation Defined

"10 times the aggregate adjusted bases of qualified small business stock issued by such corporation and disposed of by the taxpayer during the taxable year."

NOT defined in terms of QSBS "Eligible Gain" (3-, 4-, or 5-year holding period) of the taxable year.

Exercise option to purchase $4 million for $1 million QSBS ($3 million of ordinary income)

+

(Non-Eligible Gain)
Sell option-acquired QSBS stock for nominal gain

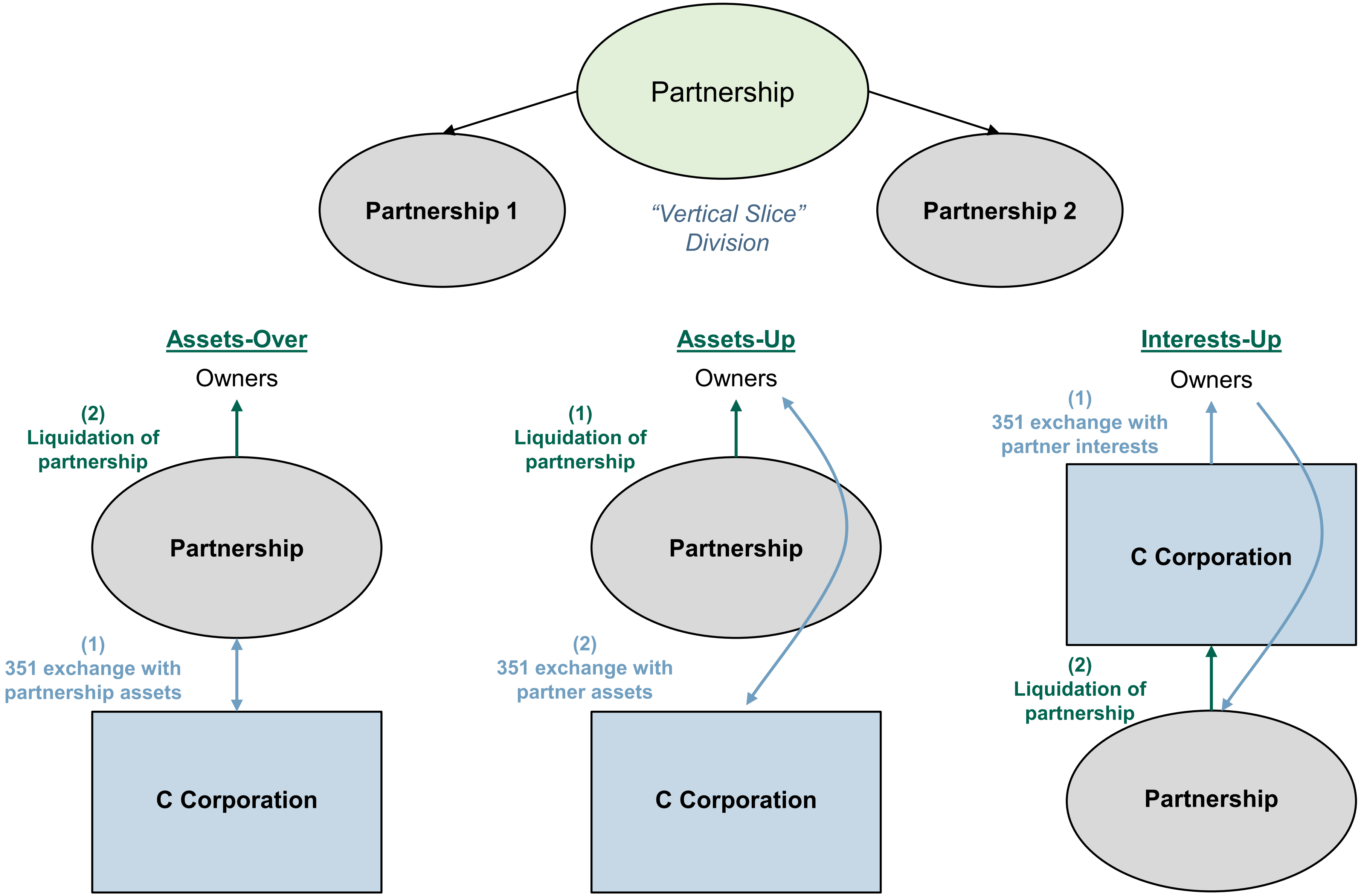
+

(Eligible Gain)
Sell $0 basis QSBS held for more than 5 years for $40 million of gain

=

$40 Million Per-Issuer Limitation

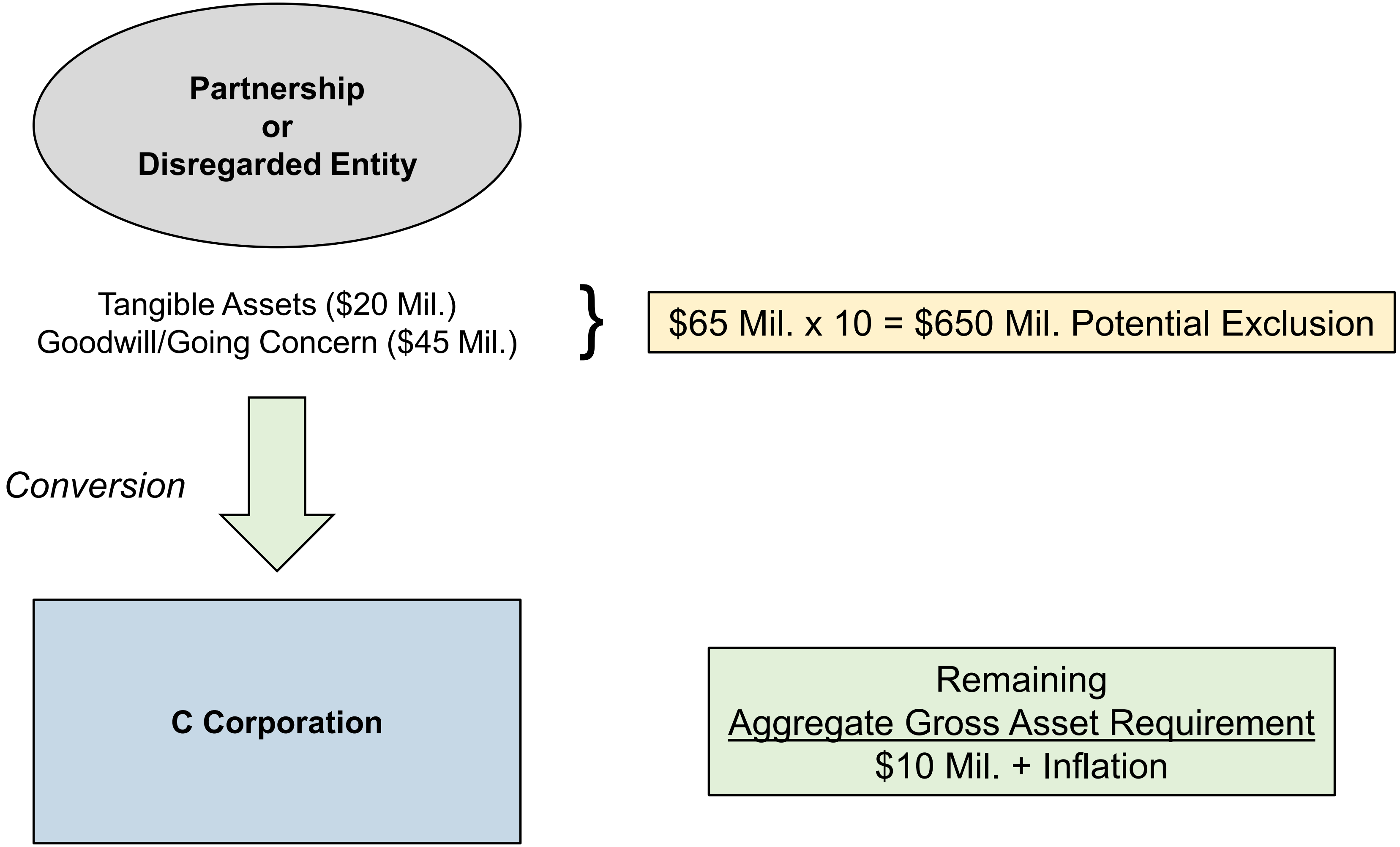
Conversion from Partnership to C Corporation



<u>Anti-Abuse Consideration</u>

"The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of this section through split-ups, shell corporations, partnerships, or otherwise." § 1202(k).

Conversion with Fair Market Value of Goodwill and Going Concern



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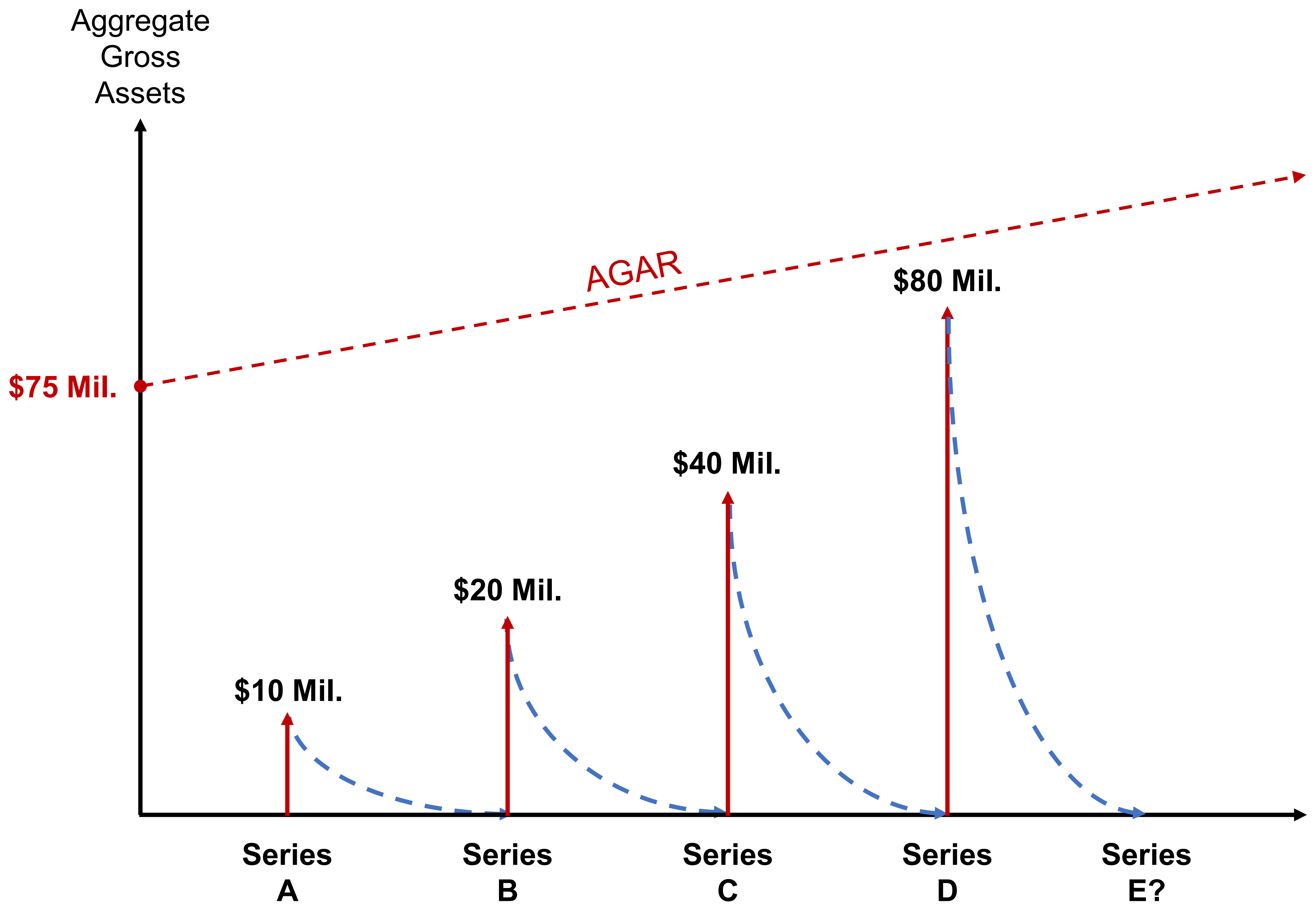
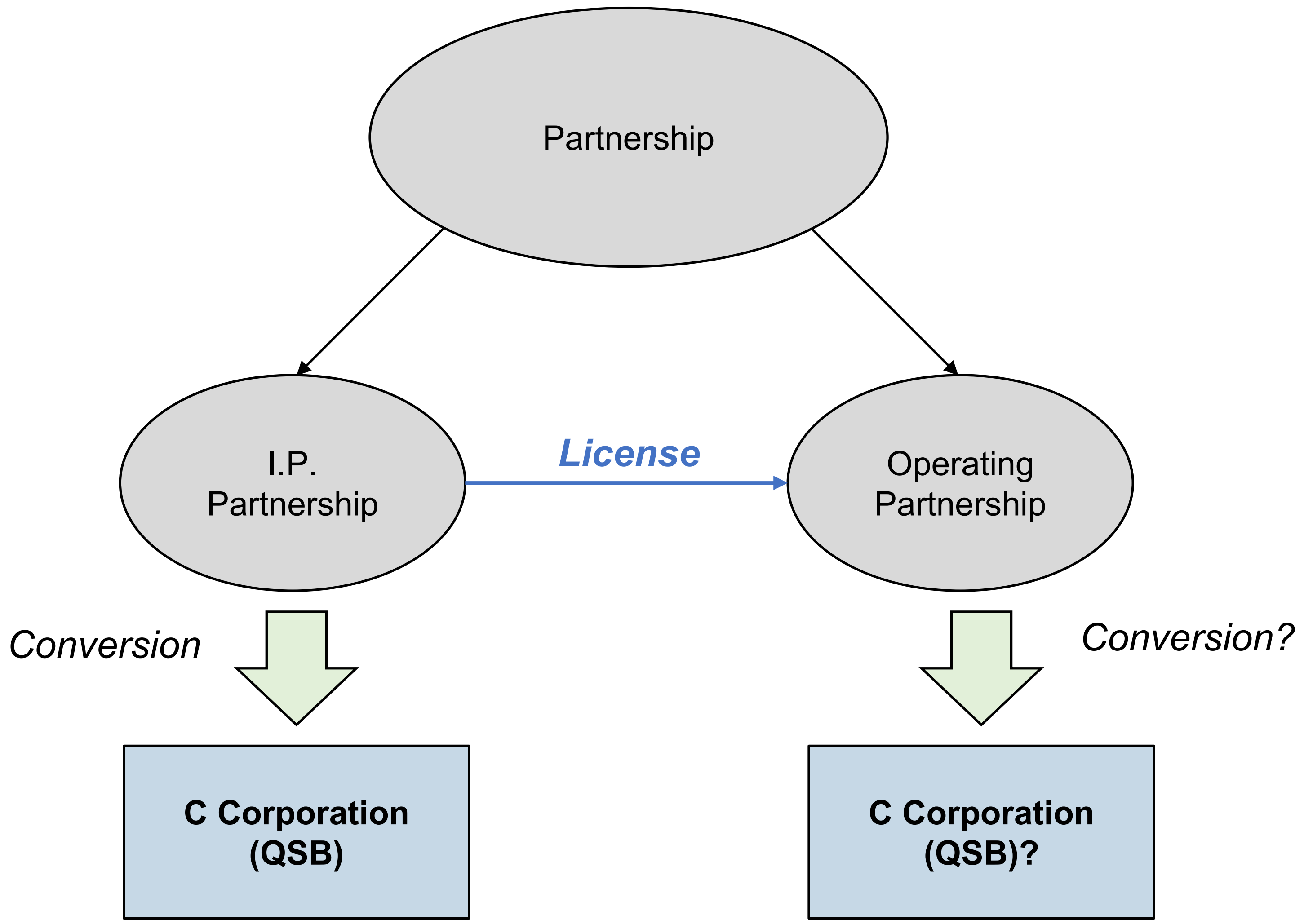
Serial Rounds of Funding



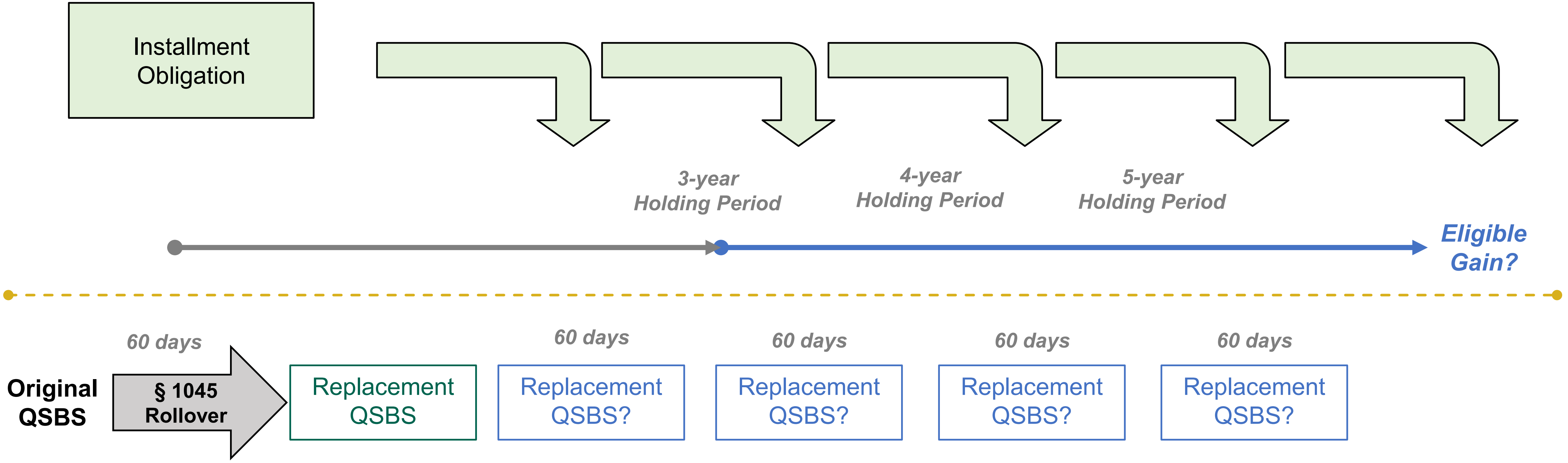
Cumulative Tax Basis
$150 Mil.

Potential Exclusion
$1.5 Bil.

Division of Intellectual Property and Sister Corporation



Installment Sales: QSBS and Section 1045 Rollovers



Schedule D Instructions

Year 1	Year 2
$10 Mil.	$4 Mil.

Excluded Section 1202 Gain

($7.1 Mil.) ($2.9 Mil.)

VS.

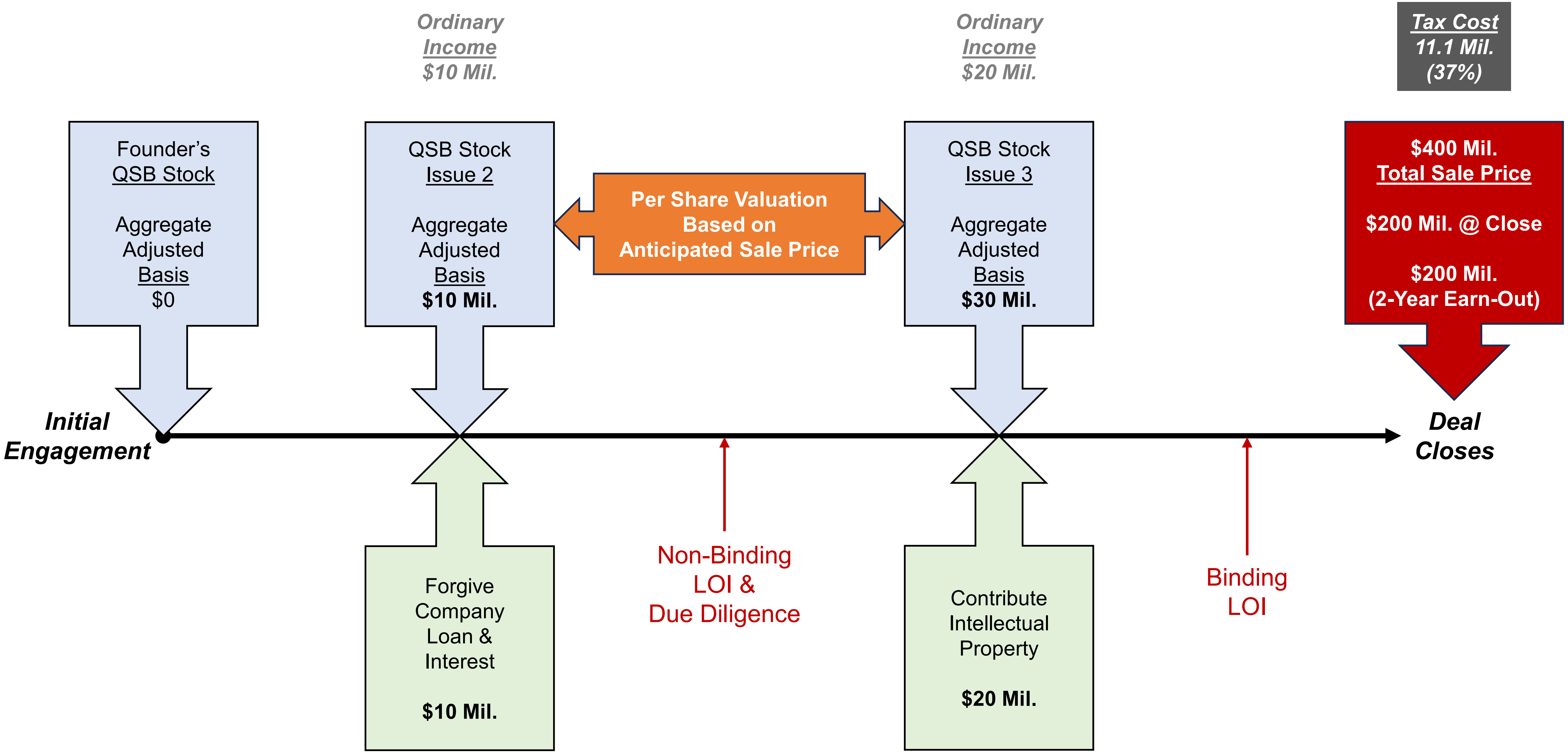
Installment Sale Gross Profit Ratio

Year 1	Year 2
$10 Mil.	$4 Mil.

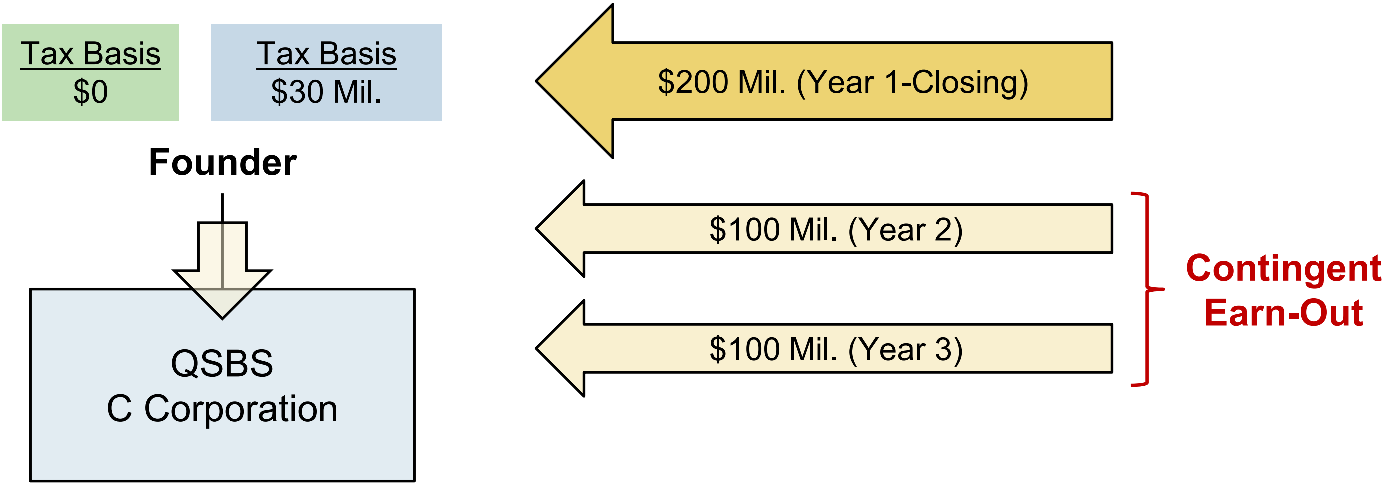
Excluded Section 1202 Gain

($10 Mil.) ($0.0 Mil.)

Packing: Anticipating a Successful Liquidity Event



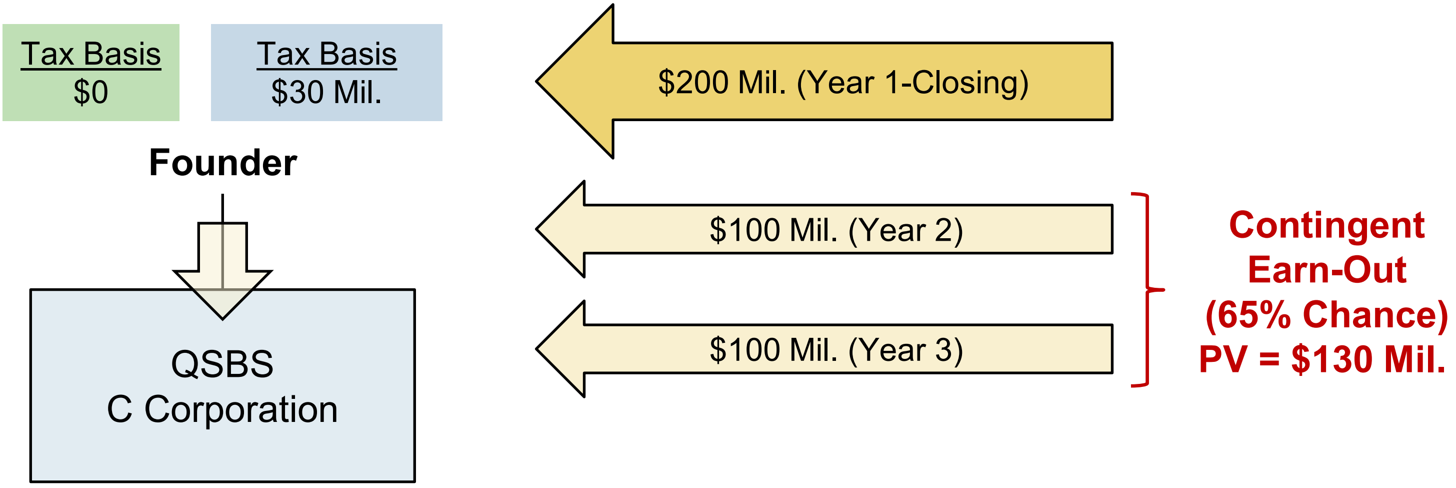
Default: Contingent Installment Method and Earn-Outs



Tax Year	Cash Payment	Amount Realized	Tax Basis	QSBS Exclusion 10 Times Basis ($300 Mil. Total)	Non-Section 1202 Gain (23.8%)	Tax Due
1	$200 Mil.	$200 Mil.	$15.0 Mil.	$150 Mil.	$35.0 Mil.	$8.33 Mil.
2	$100 Mil.	$100 Mil.	$7.5 Mil.	$75 Mil.	$17.5 Mil.	$4.17 Mil. + Interest Charge on $35.0 Mil. of Deferral ($35.0 Mil. x 23.8% = $583,100 @ 7%)
3	$100 Mil.	$100 Mil.	$7.5 Mil.	$75 Mil.	$17.5 Mil.	$4.17 Mil. + Interest Charge on $17.5 Mil. of Deferral ($17.5 Mil. x 23.8% = $291,550 @ 7%)
Total	**$400 Mil.**	**$400 Mil.**	**$30 Mil.**	**$300 Mil.**	**$70.0 Mil.**	**$16.66 Mil. + $874,650 Interest Charge @ 7%**

PLUS
Tax Cost
11.1 Mil.
(37%)

Elect Out: Contingent Installment Method and Earn-Outs



Tax Year	Cash Payment	Amount Realized	Tax Basis	QSBS Exclusion 10 Times Basis ($300 Mil. Total)	Non-Section 1202 Gain (23.8%)	Tax Due
1	$200 Mil.	$330 Mil.	$30.0 Mil.	$300 Mil.	$0	$0
2	$100 Mil.	$0	$0 Mil.	$0	$0	$0 (No Interest Charge)
3	$100 Mil.	$70 Mil.	$0 Mil.	$0	$70 Mil.	$16.66 Mil (No Interest Charge)
Total	**$400 Mil.**	$400 Mil.	**$30 Mil.**	**$300 Mil.**	**$70.0 Mil.**	**$16.66 Mil. (No Interest Charge)**

Deferral

PLUS
Tax Cost
11.1 Mil.
(37%)

Disclosures

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