



# Qualified Small Business Stock (QSBS) (IRC §1202)

## Capital Gains Exclusion Analysis & Eligibility Documentation by InteleK

For founders, investors, and employees of eligible private companies, QSBS under IRC §1202 offers one of the most powerful tax exclusions available – up to \$10 million (or 10x basis) of capital gains excluded from federal income tax. InteleK's accredited valuation and tax specialists provide independent analysis and documentation to help you understand, track, and substantiate QSBS eligibility.

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# Why QSBS Eligibility Matters

For founders, investors, and employees of eligible private companies, QSBS under IRC §1202 can be a game-changer for wealth creation – effectively making a portion of your exit proceeds **entirely tax-free**. However, qualifying is complex, with strict requirements that must be met by both the company and the stock itself, from the date of issuance through the date of sale.

## The Opportunity

Exclude up to \$10 million (or 10x basis) of capital gains from federal income tax – one of the most powerful incentives in the tax code for early investors and founders.

## The Risk

Missing even one eligibility criterion can disqualify your stock entirely, leading to a significant and unexpected tax bill at exit. Careful documentation is essential from day one.

## The Solution

Independent QSBS eligibility analysis and documentation from an accredited specialist is the most critical safeguard for founders, investors, and early employees.

## IRC §1202 — Core Company Requirements

To qualify for the significant capital gains exclusion under IRC §1202, the issuing company must meet several stringent requirements applied **continuously from the date of issuance until the date of sale**. These rules are designed to target active operating businesses, not passive investment vehicles.

The issuing company must be a **domestic C-corporation** (not an S-corporation, LLC, or partnership) at the time the stock is issued, and substantially all of its assets must be used in the active conduct of a qualified trade or business. Its aggregate gross assets must not have exceeded **\$50 million immediately after stock issuance**, and the corporation cannot have engaged in significant redemptions of its own stock around the time of QSBS issuance.

# Key Company-Level Eligibility Considerations

## **Domestic C-Corporation Only**

The company must be a domestic C-corporation at issuance. Stock issued by an S-corporation, LLC, or partnership does not qualify under IRC §1202 – no exceptions.

## **\$50 Million Gross Assets Test**

Aggregate gross assets (including predecessors) must not have exceeded \$50 million at all times from December 31, 1992 through immediately after the stock issuance. Assets are valued at adjusted tax basis, not fair market value.

## **Active Qualified Trade or Business**

At least 80% (by value) of the corporation's assets must be used in the active conduct of a qualified trade or business for substantially all of the taxpayer's holding period. Certain service businesses are excluded.

## **Redemption Restriction**

The corporation cannot have engaged in significant redemptions of its own stock in the period around the time of the QSBS issuance. Such redemptions can retroactively disqualify otherwise eligible stock.



#### STOCK-LEVEL REQUIREMENTS

## Stock-Level Requirements for QSBS

Beyond the company-level requirements, the stock itself must satisfy three independent conditions. These apply to the individual taxpayer and cannot be met retroactively — proper structuring at the time of issuance is essential.

- ⚠️ **Critical Point:** Stock acquired in the secondary market does *not* qualify as QSBS. Only stock acquired directly from the corporation at original issuance — in exchange for money, property, or services — is eligible under IRC §1202.

5-YEAR HOLDING PERIOD

## The Three Stock-Level Rules

Each of the following requirements must be met independently. Failure of any one condition – regardless of how well the others are satisfied – results in full disqualification from the §1202 exclusion.

The stock must be acquired directly from the corporation at **original issuance** for money, property, or services. It must then be held for **more than five years** from the issuance date before sale. For employee stock options, the five-year holding period begins on the date of exercise, not the grant date. Finally, the corporation cannot have been **publicly traded** at any time during the holding period.



# The Benefits — Capital Gains Exclusion

For eligible QSBS, a taxpayer can exclude from gross income the **greater of \$10 million or 10 times the adjusted basis** of the QSBS sold in that tax year. This exclusion is applied **per taxpayer, per company** — meaning a married couple each holding QSBS in the same company could potentially exclude \$20 million in gains combined.

- \$10 million exclusion per taxpayer, per company
- Or 10x adjusted basis — whichever is greater
- 100% exclusion for stock acquired after September 27, 2010
- Rollover provision available under IRC §1045 for early exits

**\$10M**

**Per-Taxpayer Exclusion**

Or 10x adjusted basis if  
greater

**100%**

**Gain Excluded**

For stock acquired after Sept.  
27, 2010

**5 Yrs**

**Minimum Hold**

Required before qualifying sale

# The \$50 Million Gross Assets Test — A Critical Hurdle

The \$50 million gross assets test is often the most challenging requirement for rapidly growing companies. It applies not just at the time of issuance, but *immediately after* issuance, and looks back to December 31, 1992 (or the company's inception if later). Assets are valued at their **adjusted tax basis**, not fair market value — and both cash and assets contributed to a partnership by the corporation are included.

A Series B or C round could fail the test even if earlier seed or Series A rounds qualified. Careful monitoring of the balance sheet around **every financing event** is essential to preserve QSBS status for each issuance.

## Point-in-Time Test

Once your stock qualifies as QSBS at issuance, it generally retains that status even if the company's gross assets later exceed \$50 million. The test is primarily applied at issuance.

## Round-by-Round Risk

Each new stock issuance is tested independently. A later financing round that pushes gross assets over \$50 million will disqualify only that specific issuance — not prior qualifying rounds.

## InteleK's Analysis

InteleK provides a QSBS Gross Assets Test Analysis to help companies track and document compliance with this critical requirement around every financing event.

# The Active Qualified Trade or Business Test

1

## The 80% Asset Use Requirement

At least 80% (by value) of the corporation's assets must be used in the active conduct of a qualified trade or business for substantially all of the taxpayer's holding period. This targets operating businesses, not passive investment vehicles.

2

## Excluded Business Types

IRC §1202 specifically excludes professional services (law, health, accounting, consulting, engineering, architecture), banking, insurance, financing, leasing, farming, hotels, restaurants, and mining businesses.

3

## Working Capital & R&D

The IRS allows a reasonable amount of working capital to be held for future business needs. Assets used in research and development are generally considered part of an active trade or business.

4

## Start-Up Phase Eligibility

A company in its start-up phase can still qualify if it is actively engaged in activities to establish a qualified trade or business – even before generating revenue.

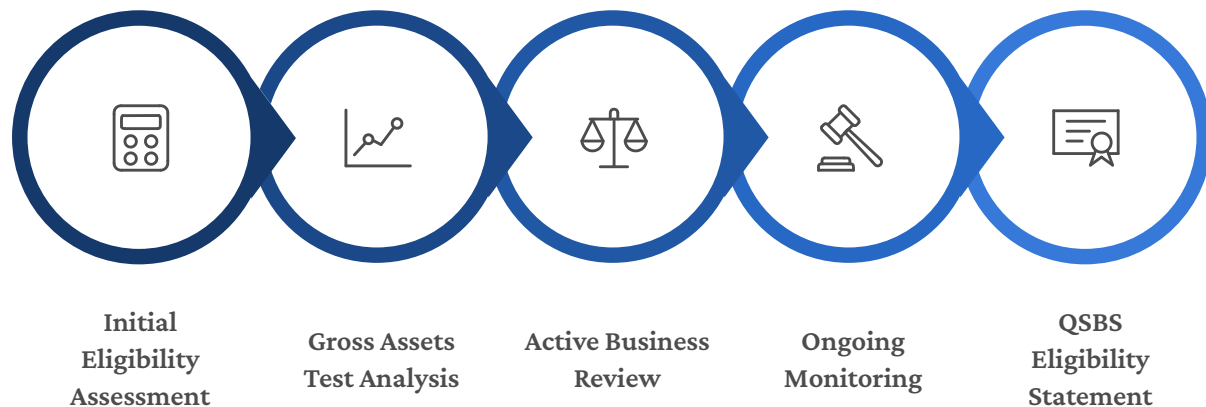
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## Rollover Provision (IRC §1045)

If you sell QSBS held more than six months but less than five years, you may roll over the gain into new QSBS within 60 days – deferring the tax and potentially allowing the new stock to qualify for the full exclusion.

# IntelK's QSBS (IRC §1202) Approach

Our accredited valuation and tax specialists bring deep expertise in IRC §1202 to help you navigate the complexities of QSBS. Every engagement is built to deliver a defensible, documented eligibility position – from initial assessment through an eventual exit.



Our proven approach first establishes initial eligibility, then carefully monitors and documents compliance throughout the holding period – ensuring all requirements are satisfied when it matters most: at exit.



# What Sets IntelleK's QSBS Process Apart



## Comprehensive Eligibility Assessment

We perform a thorough review of your company's history, financials, and business activities to determine QSBS eligibility at the time of stock issuance – identifying any potential disqualifying factors before they become a problem.



## Gross Assets Test Documentation

We track and document compliance with the critical \$50 million gross assets test, particularly around financing events, to ensure each stock issuance independently qualifies – from seed through Series C and beyond.



## Active Business Test Analysis

We analyze your company's business activities to confirm it meets the active qualified trade or business requirements – with particular focus on potentially excluded service businesses where eligibility is most contested.



## Defensible Documentation Package

The burden of proof rests with the taxpayer. We build a robust QSBS documentation package – including eligibility statements for shareholders – that can withstand IRS scrutiny and mitigate audit risk.



# Collaboration With Your Advisory Team

InteleK doesn't work in isolation – we work **alongside your advisory team** to ensure QSBS planning integrates seamlessly into your broader tax strategy, exit planning, and investor communications.

## → **Tax Attorneys & CPAs**

We coordinate with legal counsel and tax preparers to ensure the QSBS eligibility analysis supports filing positions, investor agreements, and exit documentation – reducing friction and improving defensibility.

## → **Wealth Advisors & Family Offices**

Our reports are structured to integrate directly into broader wealth planning – ensuring QSBS strategy is coordinated with estate planning, gifting programs, and long-term capital gains management.

## → **Founders, Investors & Cap Table Managers**

We provide the independent, accredited analysis that founders, VCs, and angel investors need to document QSBS eligibility for each class of stock at every round of financing.

# QSBS (IRC §1202) Compliance: Key FAQs

Expert insights into QSBS eligibility, the \$10 million exclusion, 5-year holding period, and compliance with IRC §1202 in 2026.

## What is QSBS and how much gain can I exclude?

QSBS under IRC §1202 allows you to exclude up to \$10 million (or 10 times your adjusted basis in the stock, if greater) of capital gains from federal income tax upon its sale – per taxpayer, per company.

## Does the \$50M gross assets test apply at issuance or continuously?

The test applies at all times from December 31, 1992 (or company inception) until *immediately after* the stock issuance. Once stock qualifies at issuance, it generally retains QSBS status even if gross assets later exceed \$50 million.

## What are the key stock-level requirements for QSBS?

The stock must be acquired at original issuance directly from the corporation in exchange for money, property, or services – and held for more than five years. Secondary market acquisitions do not qualify.

## Are all types of businesses eligible for QSBS?

No. IRC §1202 excludes professional services (law, health, accounting), banking, finance, farming, hospitality, and mining businesses. The company must be actively engaged in a "qualified trade or business."

## Can employees receive QSBS through stock options?

Yes, but indirectly. Options themselves are not QSBS. When an employee exercises a stock option and acquires shares directly from the company, those shares can qualify as QSBS if all other requirements are met. The 5-year holding period begins on the date of exercise.

## Can S-Corporation stock qualify as QSBS?

No. One of the fundamental requirements is that the issuing company must be a domestic C-corporation at the time the stock is issued. Stock issued by an S-corporation, LLC, or partnership does not qualify under IRC §1202.

## What documentation do I need to prove QSBS eligibility?

You'll need stock certificates (proving original issuance and date), financial statements (demonstrating compliance with the \$50M gross assets test), corporate records, business plans, and potentially a formal QSBS eligibility statement from the company.

## What happens if I sell QSBS before five years?

Under IRC §1045, if you sell QSBS held more than six months but less than five years, you may roll over the gain into new QSBS within 60 days – deferring tax and potentially preserving eligibility for the full exclusion once the new stock's five-year period is met.

ABOUT US

# About IntelleK

## Business Valuations For Today.... & Tomorrow

Business Valuations are an "opinion of value" so finding the right professional valuer is key, an opinion with trust. Business Valuations need the combination of science (technology) and art (knowledge & experience).

IntelleK embraces the two worlds to deliver the most robust and efficient service to its clients, adapting to the ever changing environment of businesses and how to value them.

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OUR PURPOSE

## Transferring Business Valuation Knowledge to Business Owners

Most business owners don't know the value of the business, let alone where the value comes from, how to influence / increase it, or where the risk exposure is, which limits its potential.

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