Lowenstein Sandler

Client Alert

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One Big Beautiful Bill and Opportunities To Avoid or Defer Tax on Gains

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On July 4, 2025, President Donald Trump signed into law the One Big Beautiful Bill Act (H.R.1) (OBBBA). This alert focuses on OBBBA changes regarding qualified small business stock (QSBS) and qualified opportunity zone (QOZ) provisions. QSBS and QOZs offer investors the opportunity to avoid capital gains tax on these specialized holdings.

QSBS Provisions

In general, if an individual acquires QSBS at original issuance, holds the stock for a required holding period, and later sells the QSBS, the individual can exclude up to 100 percent of the gain on such sale from capital gains tax.
OBBBA makes three key changes to the QSBS provisions of the Internal Revenue Code (Code). **Importantly, these changes only apply to QSBS treated for tax purposes as acquired after July 4, 2025.**

1. Reduced Holding Period To Access QSBS Benefits

   Prior to OBBBA, stockholders could only claim QSBS benefits if the stock had been held for more than five years. OBBBA introduces a tiered benefit structure, allowing holders to access 50 percent of the eligible gain exclusion after three years, 75 percent after four years, and 100 percent after five years.

2. Increased QSBS Gain Exclusion Cap

   Prior to OBBBA, the amount of gain eligible for the QSBS exclusion was generally the greater of $10 million or 10 times the stockholder's basis in the stock (typically, the amount the stockholder paid for it). OBBBA increases the $10 million gain exclusion cap to $15 million, thereby enhancing the potential tax benefit for eligible stockholders. In addition, the $15 million cap will be indexed for inflation for tax years beginning in 2027.

3. Increased Limit on Size of Qualified Small Business

   Prior to OBBBA, stock could only qualify as QSBS if the corporate issuer's aggregate gross assets did not exceed $50 million at any time before or immediately after the issuance of the relevant stock. OBBBA increases this gross asset threshold to $75 million. The $75 million will be indexed for inflation for tax years beginning in 2027.

These changes enable more corporations to qualify for QSBS status, allow for more flexibility in the timing of QSBS planning, and permit the exclusion of more gain from capital gains tax upon the sale of QSBS acquired after enactment of OBBBA. Nothing in OBBBA cuts back on the ability to multiply these benefits by using separate trusts to hold QSBS, each of which can independently take advantage of QSBS benefits.

Takeaway: These changes meaningfully increase the opportunity and value to founders and early investors of QSBS and are meant to encourage investment in new ventures. If you are considering acquiring stock in a corporation that may qualify for QSBS treatment under these new requirements, or if you already own QSBS and are curious about the estate planning and exit options available to you, we welcome you to consult with a member of Lowenstein Sandler's Private Client Services Group for further consideration of your planning goals in light of the new legislation.

Caution: Four states—Alabama, California, Mississippi, and Pennsylvania—don't provide any special state income tax treatment for QSBS.

QOZ Provisions

Opportunity zones and their special tax treatment were created by the 2017 Tax Cuts and Jobs Act (TCJA). When a taxpayer recognizes gain from a sale or other taxable transfer to an unrelated party and then timely reinvests some or all of that gain in a qualified opportunity fund (QOF), the taxpayer may elect to defer federal income tax on that reinvested amount. QOFs need to conduct their activities primarily in QOZs (disadvantaged areas) and satisfy a number of other requirements relating to their assets and operations. The taxpayer generally must recognize the deferred gain upon disposition of the QOF investment but no later than December 31, 2026. However, the taxpayer may be able to exclude a portion of the deferred gain and all subsequent appreciation in the QOF investment, depending on how long the taxpayer has held the QOF investment.

Like most TCJA provisions, the QOZ provisions were time-limited, only applying to reinvestments of gains from transactions occurring on or prior to December 31, 2026. The potential deferral benefits with respect to the TCJA are currently quite limited, as gains deferred under the TCJA QOZ provisions will be recognized no later than December 31, 2026, and investments can no longer be made that will qualify for the exclusion of deferred gain.

OBBBA effectively makes the QOZ tax program permanent, with some modifications. For investments in QOFs made after December 31, 2026, the QOZ rules are:

- Gains invested in a QOF must be recognized on the earlier of the date of disposition of the QOF investment or the fifth anniversary of the QOF investment.
- The basis in the QOF investment is increased by 10 percent of the deferred gain if the taxpayer holds the QOF investment for at least five years (effectively allowing the taxpayer to avoid tax on that 10 percent).
- If the QOF investment is held for between 10 years and 30 years, the taxpayer can elect to step up the tax basis of the QOF investment to its fair market value as of the date of its sale or disposition, thereby eliminating federal income tax on all appreciation in the QOF investment.
- If the taxpayer holds the QOF investment for at least 30 years, the basis step-up is limited to the QOF investment's fair market value on the 30th anniversary of the investment. Gain attributable to appreciation after that date will be taxable.

For example, assume a taxpayer recognizes $100,000 of gain on a sale of an asset to an unrelated party on June 1, 2027. On July 1, 2027, the taxpayer invests $100,000 in a QOF and makes the QOZ gain deferral election. The initial tax basis of the QOF investment will be $0 (that is, the amount of the deferred gain is subtracted from the actual acquisition cost). If the taxpayer continues to hold the QOF investment until July 1, 2032, on that date the QOF investment's basis will increase to $10,000 (10 percent of the deferred $100,000 gain). The taxpayer then must recognize $90,000 of the deferred gain (assuming that the fair market value of the QOF investment is at least $100,000). The QOF investment's basis then increases by that $90,000, to a total of $100,000. Assume that the taxpayer sells the QOF investment for $200,000 (the investment's then fair market value) on or after July 1, 2037 (i.e., having held the QOF investment for at least 10 years). The taxpayer can elect to adjust the tax basis of the QOF investment to its fair market value on the date of sale or disposition ($200,000), so that there is no taxable gain from the sale. If the taxpayer instead holds the QOF investment until July 1, 2057, or longer (30 years or more), the election would be to step up the tax basis to the fair market value of the QOF investment on July 1, 2057.

Under OBBBA, the determination of which geographic areas are designated as opportunity zones will be reviewed every 10 years. OBBBA adds enhanced tax benefits for investments in "rural opportunity zones." Special designations under current law for areas in Puerto Rico will expire at the end of 2026. OBBBA also repeals a rule that permitted certain census tracts that were contiguous with tracts designated as opportunity zones to be treated as opportunity zones.

Planning Tip: The potential tax deferral and exclusion benefits can provide significant incentives for making a QOF investment. As with any other investment, however, it is essential to evaluate the nontax economics of a proposed QOF investment. If the QOF isn't independently a good investment, the potential tax savings may not outweigh the economic cost.

For a discussion of other OBBBA provisions that impact high-net-worth individuals, please see our client alerts on the gift, estate, and generation-skipping transfer tax provisions and deductions for charitable contributions by individuals.

This Alert provides only a basic overview of what are complex and nuanced tax provisions. Please contact your Lowenstein Sandler lawyer for more information.

Contacts

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