

THE
CYNOSURE
GROUP

QSBS for Founders and Investors: Blueprint to Unlocking the Tax Exclusion

“Helping Good People Do Great Things”

Disclosures

The Cynosure Group, LLC is an SEC-registered investment adviser engaged in providing investment advisory and wealth management services, as well as providing investment advice with regard to private equity with other alternative investments. A detailed description of The Cynosure Group, LLC, is available in its Form ADV Part 1, Part 2A firm brochure, and Form CRS, which may be found at www.adviserinfo.sec.gov. The Cynosure Group, LLC is a part of The Cynosure Group (herein collectively referred to as “Cynosure”). This communication does not constitute an offer to sell or the solicitation of an offer to buy any specific investment product sponsored by or investment advisory services provided by The Cynosure Group, LLC, or any of its affiliates. SEC Registration does not imply a certain level of skill or training.

Past performance does not guarantee future results and there can be no assurance that investors will not lose any or all of their invested capital.

QSBS/Tax Framework. The Qualified Small Business Stock (QSBS) overview summarizes selected provisions of IRC §1202/§1045 and omits many conditions and exceptions (e.g., active-business tests, specialized-service exclusions, redemptions/aggregation rules, original-issuance, basis rules, holding periods, and state non-conformity). The §1202 exclusion is generally limited per taxpayer, per issuer to the greater of (i) \$10MM of gain (\$15MM for post-OBBA stock) or (ii) 10× basis, subject to multiple limitations. Federal and state law may diverge; several states do not follow §1202. Outcomes depend on individual facts and may change with future legislation, regulations, or guidance.

Hypothetical Examples/Illustrations. Any charts or dollar amounts (e.g., effective rates or “savings”) are hypothetical and for illustration only, based on stated assumptions (often a 28% federal LTCG rate plus 3.8% NIIT applied to the non-excluded portion; excludes AMT, phase-outs, state/local taxes, transaction costs, and caps). Actual results will differ and may be higher or lower..

No Guarantee; Forward-Looking Statements. Statements about potential benefits (including reduced effective tax rates or “eliminating federal tax”) are subject to significant uncertainties and are not assurances of any result. Legislative references (e.g., “OBBA”) reflect provisions enacted as of July 4, 2025, and may change.

§1045 Rollovers. Section 1045 can defer (not eliminate) tax on eligible QSBS gain rolled into replacement QSBS within 60 days of the sale, subject to strict requirements (e.g., continuous QSBS status, basis/holding-period tacking, per-taxpayer rules, and various anti-abuse/aggregation provisions). Failure to satisfy requirements, subsequent disqualification of the replacement issuer, or state non-conformity can trigger current or later tax. Availability may be limited for interests held through blockers or certain fund structures.

MCWAQSBS20250912x

Disclosures

Trust/“Multiple Exclusion” Planning. Any references to using multiple trusts or other techniques to increase exclusions are highly fact-specific and may be limited by federal/state tax rules, anti-abuse doctrines (including step-transaction principles), grantor/non-grantor status, and transfer-tax constraints. Such strategies carry legal, tax, and administrative risks and may be challenged by tax authorities.

Funds, Flow-Through & LPs. Potential QSBS benefits typically flow through partnerships to partners that were owners before the fund’s acquisition of QSBS and that meet all other requirements. Timing, fund structure (e.g., partnerships vs. corporations/blockers), side vehicles, secondary interests, and special allocations can affect eligibility. Proper documentation/K-1 reporting is required; not all investors will qualify.

State-Tax Planning. State rules vary widely (residency/nexus, grantor-trust rules, throwback taxes, sourcing). “Zero-tax” jurisdictions present material legal, tax, and practical considerations and may still impose tax depending on facts. State outcomes are not guaranteed.

Information Sources. Information is believed reliable but is provided “as is,” without representation or warranty as to accuracy or completeness. We undertake no obligation to update this material. Assumptions and law are current as of September 12, 2025.

Forward-Looking/Legislative Status. References to the One Big Beautiful Bill Act (OBBBA) reflect [provisions enacted as of July 4, 2025], and may change.

Records. Information is believed reliable but provided “as is,” without warranty, as of September 12, 2025.

The Cynosure Group, LLC, and its affiliates do not provide tax, legal or accounting advice. This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for tax, legal, or accounting advice. You should consult your tax, legal, and accounting advisors before engaging in any transaction.

Qualified Small Business Stock (“QSBS”) QSBS Overview

What is QSBS and how was it Enhanced by OBBBA?

Qualified Small Business Stock (“QSBS”) refers to stock in a C corporation that meets specific criteria under Internal Revenue Code (“IRC”) Section 1202. Its key purpose is encouraging investments in small business through tax incentives. Traditionally, QSBS offered a **100% exclusion from federal income tax** on capital gains up to \$10MM, provided the stock was held for a **5-year holding period**. The One Big Beautiful Bill Act (“OBBBA”) introduced significant enhancements for stock issued after 07/04/25 (while retaining prior benefits for stock issued before 07/04/25).

Major Legislative Enhancements in OBBBA

1

Increased Asset Threshold

The gross asset threshold for a corporation to qualify as a small business has been increased from **\$50MM to \$75MM** (and indexed for inflation starting in 2027), allowing more companies to qualify.

2

New Tiered Exclusion System

A new tiered exclusion system provides flexibility for modern exit timelines:

- **50% exclusion** at 3 years holding period
- **75% exclusion** at 4 years holding period
- **100% exclusion** at 5 years holding period

3

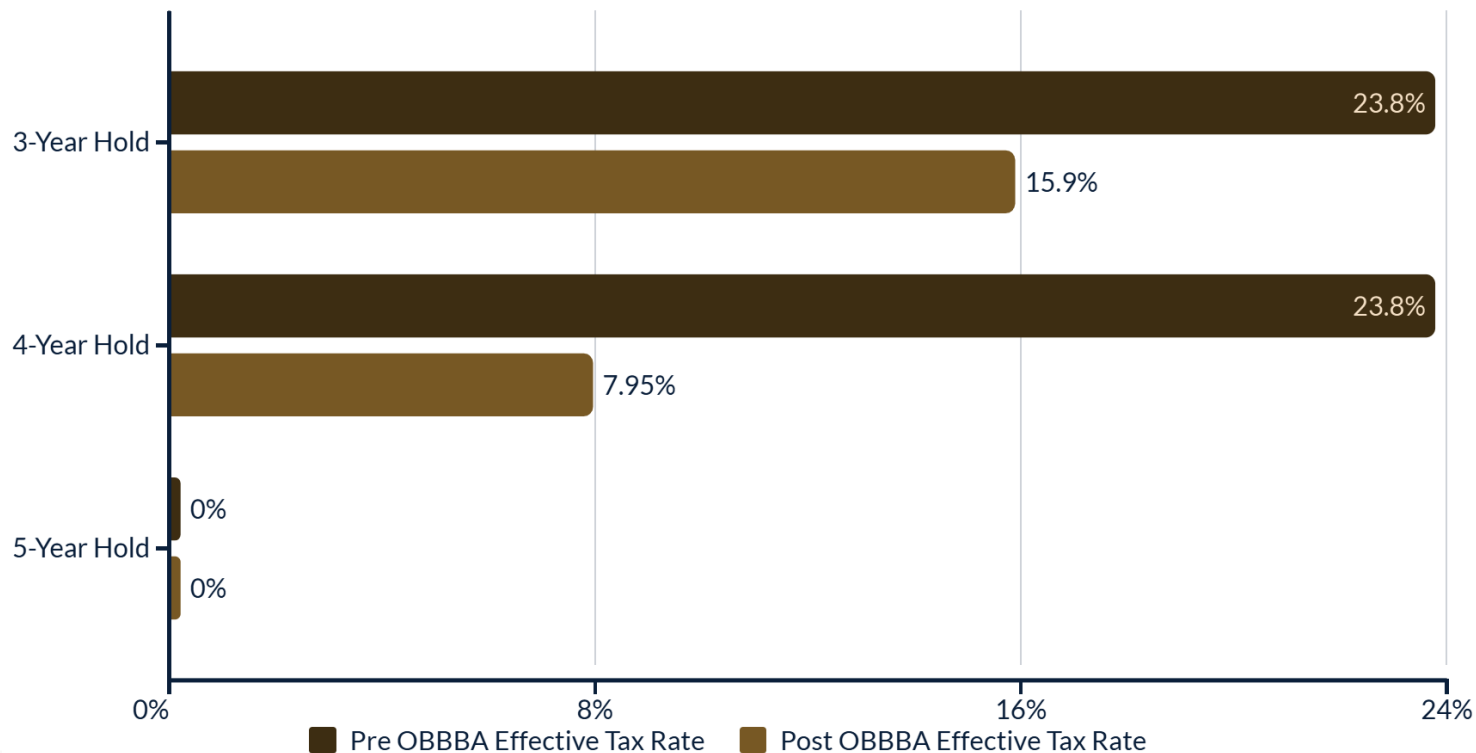
Enhanced Cap on Gain Exclusion

New cap on gain exclusion of \$15MM (up from \$10MM) and indexed for inflation beginning in 2027. These changes provide enhanced benefits, particularly for companies with modern exit timelines, making QSBS even more attractive.

Disclosures: Educational only—see Important Disclosures. Not tax, legal, or investment advice. Hypothetical illustrations; results vary.

Tiered Exclusion For Stock Issued after 07/04/25

This tiered approach provides earlier liquidity options while preserving substantial tax benefits. However, partially excluded gain is taxed at 28% capital gain rate by statute and is also subject to the 3.8% Net Investment Income Tax (“NIIT”). The 50% exclusion (first available after 07/04/2028) results in an effective tax rate of 15.9% ($\frac{1}{2}$ of 28% capital gains rate plus $\frac{1}{2}$ of 3.8% NIIT rate), while the 75% exclusion (first available after 07/04/2029) results in an effective tax rate of 7.95%



Example math: 50% exclusion $\rightarrow 50\% \times (28\% + 3.8\%) = 15.9\%$; 75% exclusion $\rightarrow 25\% \times (28\% + 3.8\%) = 7.95\%$.

Disclosures: Educational only—see Important Disclosures. Not tax, legal, or investment advice. Hypothetical illustrations; results vary.

Why QSBS Transforms Exit Economics



- The impact is substantial: a founder selling \$50MM of qualifying stock can exclude \$10MM (\$15MM for post OBBBA stock) of gain from federal taxation entirely, generating approximately \$2.38MM in federal capital gains tax savings.
- When properly structured across family trusts, that same \$50MM gain might generate multiple separate exclusions, potentially eliminating federal tax entirely on the transaction.
- The 2025 One Big Beautiful Bill Act enhanced these benefits by increasing the exclusion amount to \$15MM and creating a tiered exclusion approach that acknowledges modern exit timelines.

Disclosure: Disclosures: Educational only—see Important Disclosures. Not tax, legal, or investment advice. Hypothetical illustrations; results vary.

The Five Critical Qualifying Tests

To qualify for IRC 1202 QSBS exclusion, stock must meet five critical tests set forth in the Internal Revenue Code:

1

C-Corporation Status

The company must be a *domestic* C-corporation when stock is issued. LLCs and S-corporations do not qualify, though converting to C-corp status before issuance establishes eligibility going forward.

2

Gross Asset Ceiling

At all times before and immediately after stock issuance, the corporation's aggregate gross assets cannot exceed \$50MM (pre-07/04/25) and \$75MM (post-07/04/25)-including cash and the adjusted basis of property.

3

Active Business Requirement

During substantially all of the holding period, at least 80% of corporate assets (by value) must be used in active conduct of a qualified trade or business. Service businesses are excluded.

4

Original Issuance

Stock must be acquired directly from the corporation in exchange for money, property, or services. Secondary market purchases do not qualify. However, gifts and bequests preserve QSBS status.

5

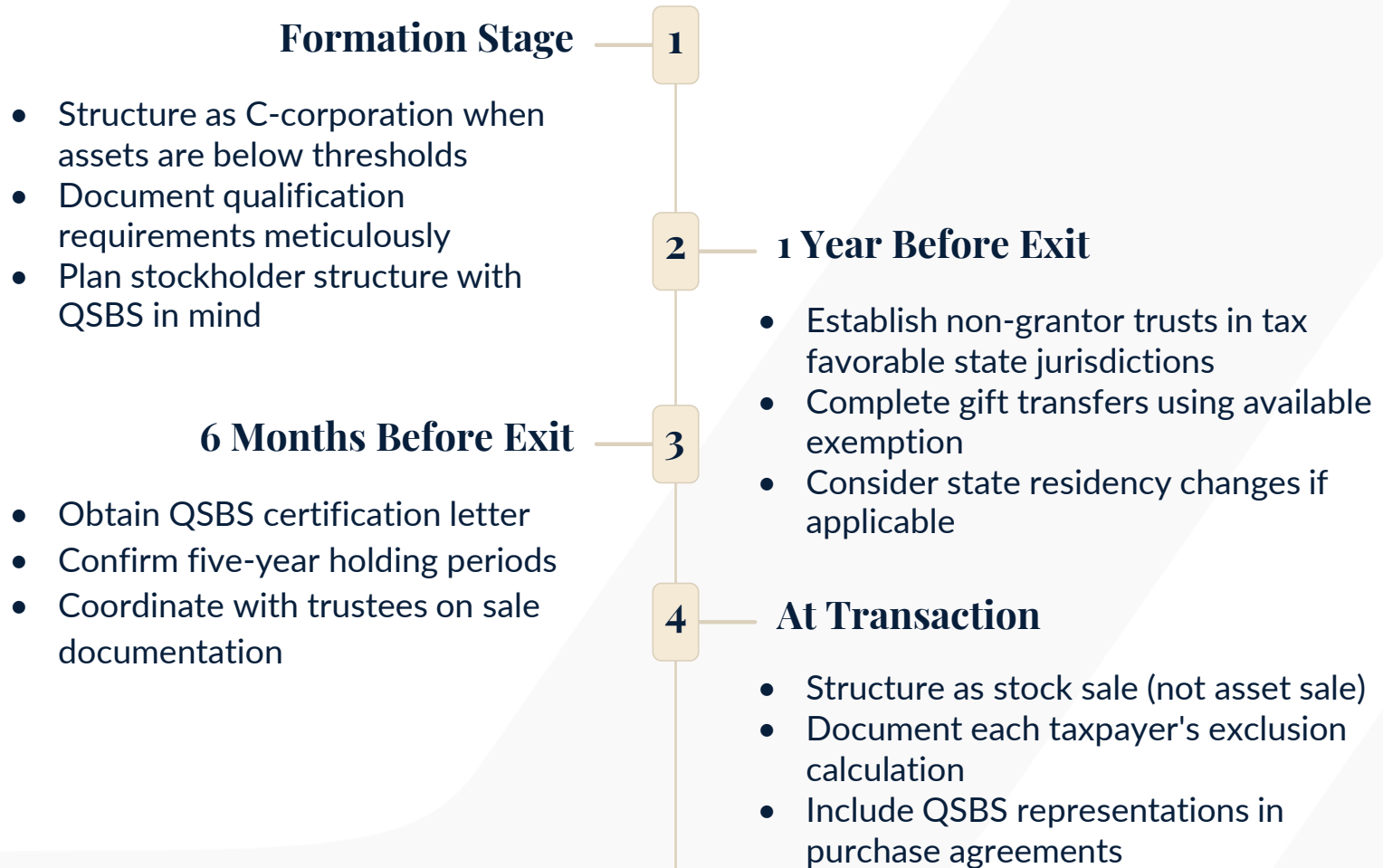
Holding Period

For 100% exclusion, stock must be held more than five years. Under 2025 rules for stock issued after 07/04/25, partial exclusions apply earlier: 50% after three years, 75% after four years.

Disclosures: Educational only—see Important Disclosures. Not tax, legal, or investment advice. Hypothetical illustrations; results vary.

Implementation Timeline

From formation to closing, the following sample timeline sequences the steps and documentation needed to achieve QSBS eligibility while capturing the exclusion at exit.



Disclosures: Educational only—see Important Disclosures. Not tax, legal, or investment advice. Hypothetical illustrations; results vary.

QSBS and IRC 1045 Rollover

Managing Excess Gains: IRC 1045 Rollover

While QSBS offers a significant federal tax exclusion, it is capped at \$10MM per-issuer (increased to \$15MM under OBBBA). When gain from the sale of QSBS exceeds this exclusion limit, the excess portion would ordinarily be subject to capital gains tax. However, IRC 1045 provides a powerful mechanism to defer taxation on these excess gains:



Exceeding the Exclusion

If capital gains from the sale of QSBS exceed the \$10MM pre-OBBBA (\$15MM post-OBBBA) per-issuer exclusion limit, the portion above this threshold becomes taxable, subject to the rollover provisions of IRC 1045.



IRC 1045 Rollover

IRC 1045 allows taxpayers to roll over these excess gains into new QSBS investments within 60 days of the sale, deferring the tax liability. This applies to the taxable portion of the gain, not the excluded portion, and can be used in combination with the new tiered exclusion rules.



Excess Gain Rollover Example

Consider a founder with a \$25MM gain from a single company. They can exclude \$10MM under pre-OBBBA QSBS provisions. The remaining \$15MM taxable gain can then be rolled over into new QSBS stock **(including a newly created qualified QSBS for taxpayers next venture)** within 60 days, avoiding immediate taxation on this excess.



Strategic Benefits

This strategy offers dual benefits: it avoids immediate tax on the excess gains and allows investors to build toward new exclusions with the replacement QSBS. It also promotes portfolio diversification by encouraging investments across multiple QSBS-eligible companies.



Integration with Tiered Exclusions

This strategy works seamlessly with the new 3-year (50% exclusion) and 4-year (75% exclusion) tiered QSBS benefits. An investor can utilize a partial exclusion on an initial sale, then roll over any remaining taxable gain into new QSBS stock to continue building toward a full 100% exclusion.

Disclosures: Educational only—see Important Disclosures. Not tax, legal, or investment advice. Hypothetical illustrations; results vary.

§1045 provides deferral only; replacement must qualify as QSBS and be acquired within 60 days. Disqualification or structural constraints (e.g., blockers) can forfeit deferral. State conformity varies.

QSBS For VCs And Their LPs

QSBS for Venture Capital Firms and Their Investors

In venture fund structures, QSBS can be a game changer: LP-level flow through, multiple exclusions across eligible companies, and rollovers to bridge early exits can significantly enhance the after-tax returns.

Flow-Through Benefits

QSBS benefits flow through fund structures to individual limited partners, with each LP claiming their own exclusion limits, making early-stage investing particularly tax-advantageous.

Stacking Exclusions

A VC firm investing in multiple qualified companies can stack exclusions across portfolio companies, with LPs potentially receiving multiple \$10MM (or \$15MM post OBBBA) exclusions.

Rollovers via IRC 1045

VC investors can utilize IRC 1045 rollovers to defer gains between qualifying investments when exits occur before the five-year mark, managing multiple investments while building toward full exclusion.



Disclosures: Educational only—see Important Disclosures. Not tax, legal, or investment advice. Hypothetical illustrations; results vary.

Flow-through depends on partnership status, timing of LP admission before original issuance, and fund/vehicle structure. Not all LPs will qualify; secondary purchases typically do not qualify for existing holdings.

Navigating the Flow-Through for VC Fund LPs

QSBS offers significant tax advantages, and for Limited Partners (“LPs”) in venture capital funds, these benefits flow through directly, making early-stage fund investments particularly attractive.

Pass-Through & LP’s Exemption

QSBS benefits pass through the fund structure directly to individual LPs. Each LP is entitled to their **own separate \$10MM (or \$15MM) exemption**, rather than the fund itself receiving a single, shared exclusion. This allows multiple LPs to claim substantial tax savings from a single successful portfolio company exit.

Documentation & Reporting

To claim the benefits, LPs must receive proper documentation. K-1s should include information necessary for the LP to report the QSBS gain on their individual tax return (Form 8949 and Schedule D). Meticulous record-keeping by funds is vital.

Holding Period & Fund Structure

The fund's holding period for the QSBS stock is directly imputed to the LPs. If the fund holds the stock for more than five years, LPs qualify for the full 100% gain exclusion. **Fund structure is paramount:** QSBS benefits typically flow through partnerships (like most VC funds).

Considerations & Misconceptions

Different LP types (individuals, family offices, institutions) may have varied tax situations, but the QSBS flow-through largely benefits individual taxpayers. **A common misconception is that the fund itself receives a single QSBS exclusion.** Fund managers must clearly communicate these mechanics.

Critical Timing: When LPs Must Invest

For LPs to receive QSBS benefits from a fund's investment, they **must be invested in the fund BEFORE the fund acquires the QSBS** (the "original issuance" requirement). An LP joining the fund after a QSBS acquisition will not qualify for benefits from those specific holdings. This impacts fundraising strategies, emphasizing the importance of closing fund commitments prior to making major QSBS-eligible investments. Secondary market LP interests typically do not qualify for QSBS benefits on existing portfolio holdings.

Disclosures: Educational only—see Important Disclosures. Not tax, legal, or investment advice. Hypothetical illustrations; results vary. K-1 reporting and substantiation are required; special allocations and side vehicles may change outcomes. Eligibility is per-partner and fact-specific.

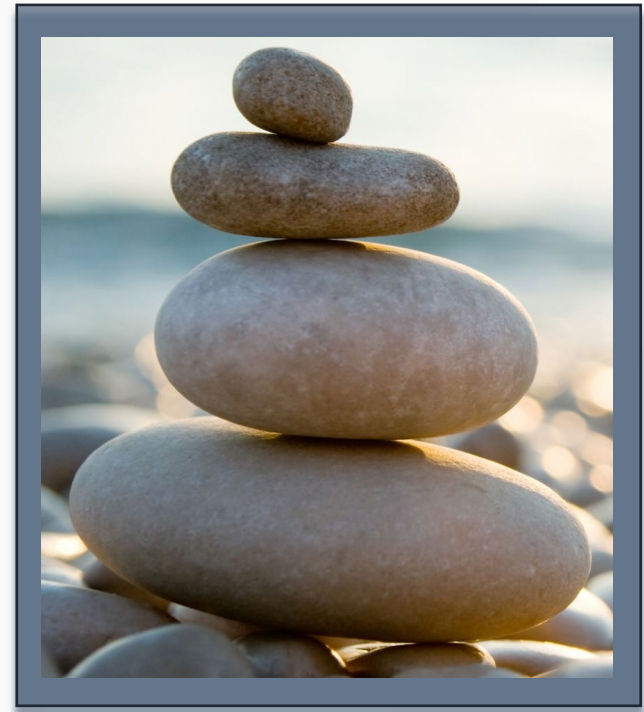
Maximizing Your QSBS Benefits

Maximizing Exclusions Through Trust Architecture

IRC 1202 grants a powerful **per-taxpayer** gain exclusion of up to **\$10MM** (\$15MM for post OBBBA issued) QSBS stock held for 5+ years.

The "stacking" strategy leverages this per-taxpayer exclusion by creating **additional taxpayers** through strategic gifts to trusts to multiply the overall exclusion amounts. Key implementation considerations for effective stacking include:

- **Gifts Preserve Attributes:** Transfers via gift or inheritance ensure the original QSBS holding period and basis are preserved for the recipient.
- **Separate Taxpayer Status:** Each entity (e.g., trust) receiving QSBS must qualify as a separate taxpayer for federal income tax purposes to claim its own exclusion.
- **5-Year Holding Period:** The QSBS must be held for a minimum of 5 years by the original holder or the transferee (combining holding periods) to qualify for the exclusion.
- **Non-Grantor Trust Structure:** Trusts must be carefully structured as non-grantor trusts to prevent the grantor from being treated as the owner for tax purposes, which would defeat the separate taxpayer objective.
- **Distinct Beneficiaries.** Each trust should **primarily** benefit different family members to avoid IRS aggregation of multiple trusts.
- **Independent Trustees.** Particularly for state tax planning purposes, trustees should be located in tax-favorable jurisdictions.



Disclosures: Educational only—see Important Disclosures. Not tax, legal, or investment advice. Hypothetical illustrations; results vary.

Trust strategies are subject to grantor/non-grantor rules, separate-taxpayer analysis, aggregation/anti-abuse doctrines, and **gift/estate tax** considerations; IRS or state challenges may limit results."

State Tax Planning & Jurisdictional Selection

Several high tax states do not follow the federal exclusion rules of IRC 1202. Choice of state trust jurisdiction (and therefore state taxation) may help mitigate state income taxes and maximize overall QSBS exclusion benefits.

Challenges in High-Tax States

Certain states, most importantly California, do not follow the federal rules for excluding QSBS gains:

- **Non-conforming states:** Do not recognize IRC 1202 (e.g., CA, PA, NJ, AL, MS, HI, PR).
- **Grantor trust treatment:** States like NY & CA may recharacterize out of state trusts as grantor trusts, subject to state taxes, if not properly structured.
- **Nexus concerns:** Trust may be taxed based on settlor, trustee, or beneficiary location.
- **High rates:** State taxes can reach up to 13.3% (CA) on capital gains.

Optimizing Trust Jurisdictions

Establish trusts in states with **zero income tax** to maximize benefits:

- **Tax favored jurisdictions:** Delaware, Nevada, South Dakota, Wyoming, Florida, Texas.
- **Best practices:** Appoint local, independent trustees and minimize connections to high-tax states.
- **Trust-friendly laws:** Leverage jurisdictions offering robust asset protection, dynasty provisions, and directed trust statutes.

To navigate these challenges, founders in high-tax states may strategically utilize completed gift non-grantor trusts in tax favored state jurisdictions to potentially avoid state-level taxation on QSBS gains.

Disclosures: Educational only—see Important Disclosures. Not tax, legal, or investment advice. Hypothetical illustrations; results vary. State residency/nexus and grantor-trust characterization can override planning; ‘zero-tax’ outcomes are **not guaranteed**. Consider throwback, sourcing, and administrative requirements.

Strategic QSBS Planning: Your Road Map

The road to effective QSBS planning demands coordination across tax, legal, and financial domains well before liquidity events materialize. Engaging qualified advisors ensures every available exclusion is captured while maintaining full compliance.



Evaluate Current Holdings

Assess your portfolio for potential QSBS qualification, including holding periods and documentation status.

Document Compliance

Ensure meticulous record-keeping of all qualification requirements from formation through exit.

Design Trust Architecture

Create a tailored trust strategy that maximizes exclusions while addressing family wealth transfer goals.

Plan Exit Timing

Coordinate liquidity events with holding period milestones to optimize tax benefits.

Disclosures: Educational only—see Important Disclosures. Not tax, legal, or investment advice. Hypothetical illustrations; results vary.



THANK YOU

<https://cynosurewealthadvisors.com/>