

# PUBLICATION

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## The One Big Beautiful Bill Act: How New QSBS Rules and Related Provisions Affect Startups and Investors

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### I. Introduction

#### Key Takeaways for Startups, Founders, and Investors:

- For stock issued on or after July 5, 2025, Qualified Small Business Stock ("QSBS") eligibility requires that the corporation's aggregate gross assets (including cash and adjusted bases of all property) do not exceed \$75 million (increased from \$50 million) immediately before and after the stock issuance. This increased threshold provides greater flexibility for qualifying companies, including those issuing equity compensation.
- Investors benefit from earlier tax advantages, with a new graduated system offering 50 percent exclusion after three years, 75 percent after four years, and 100% after five years, plus an increased applicable dollar limit of \$15 million (up from \$10 million) for QSBS issued on or after July 5, 2025.
- Additional benefits include immediate research and development (R&D) expense deductions, permanent 100 percent bonus depreciation, and relaxed business interest deduction limitations, significantly improving cash flow opportunities.

The enactment of the "One Big Beautiful Bill Act" (OBBBA) on July 4, 2025, brings these transformative changes through amendments to Section 1202 of the Internal Revenue Code (IRC) and other provisions of OBBBA. This alert analyzes these changes and their practical implications for business strategy.

### II. Key Amendments to the QSBS Framework

#### How These Changes Affect Business Strategy

The OBBBA expands several key tax benefits that might directly impact business planning and investment decisions. Here are the detailed changes and how to leverage them:

- **Shortened Holding Period Requirements:** A significant change under the OBBBA is the introduction of QSBS benefits for shorter holding periods. While the previous law required a five-year holding period for any QSBS benefits, the OBBBA now allows for partial exclusions at earlier stages, providing greater flexibility for investors and founders. For QSBS issued on or after July 5, 2025, OBBBA provides for:
  - 50 Percent Exclusion: For QSBS held for at least three years but less than four years, a taxpayer may now exclude 50 percent of the recognized capital gain.
  - 75 Percent Exclusion: For QSBS held for at least four years but less than five years, the exclusion increases to 75 percent of the recognized capital gain.
  - 100 Percent Exclusion: The 100 percent exclusion is retained for QSBS held for five years or more.

A critical nuance of this tiered structure is the tax treatment of the nonexcluded gain. The portion of the gain that is not excluded (e.g., 50 percent for a three-year holding period) is subject to the higher 28 percent capital gains tax rate, rather than the standard 20 percent long-term capital gains rate, as well as the 3.8 percent net investment income tax (NIIT). This results in an effective federal tax rate of approximately 15.9 percent for the three-year holding period and 7.95 percent for the four-year period. Importantly, any portion of the nonexcluded gain may be eligible for rollover treatment under Section 1045. Additionally, all excluded QSBS gain is fully excluded from the 3.8 percent NIIT and from being a preference item for purposes of the alternative minimum tax (AMT).

- **Increased Per-Issuer Gain Exclusion Cap:** The OBBBA increases a component of the maximum applicable dollar limit of excludable gain per taxpayer, per issuer, from the previous threshold of \$10 million to \$15 million for QSBS issued on or after July 5, 2025. This flat cap is an alternative to the 10X aggregate adjusted basis cap (which remains unchanged under the OBBBA), with the taxpayer receiving the greater of the two limits on the excluded gain. This upward adjustment, which will be indexed for inflation annually beginning in 2027, provides a meaningful boost for high-growth companies that achieve significant valuations. This change acknowledges the effects of inflation since the original cap was established in 1993 and has the potential to provide greater tax-free returns for stakeholders in highly successful ventures.
- **Increased Corporate Eligibility Threshold:** To qualify as a "qualified small business," a corporation's aggregate gross assets (both before and immediately after the issuance) must not exceed a certain threshold at the time the QSBS is issued. The OBBBA raises this threshold from \$50 million to \$75 million for stock issued on or after July 5, 2025. This increase, also subject to inflation adjustments beginning in 2027, is a pivotal change that broadens the universe of companies that can issue QSBS. It allows startups to raise more capital and grow to a more mature stage while still maintaining QSBS eligibility, thereby expanding the window for both founders and later-stage investors to benefit from the exclusion.

### III. Strategic Implications of QSBS Amendments for Stakeholders

#### Strategic Planning Opportunities Under the New Rules

- **For Founders and Startups:** The expanded gross assets threshold provides greater flexibility in fundraising. Companies can now pursue larger funding rounds without the fear of immediately exceeding the QSBS limit, which may have previously compelled them to forgo certain capital infusions or consider less tax-efficient corporate structures. The new tiered exclusion system makes equity a more attractive form of compensation for employees, as the potential tax benefits are no longer contingent on a rigid five-year timeline. This can be a powerful tool for recruiting and retaining talent, particularly in competitive markets where liquidity events may occur sooner than the five-year mark.
- **For Investors (Angel Investors, Venture Capital Firms, and Family Offices):** The increased gain cap and graduated exclusion system significantly enhance the risk-reward profile of early-stage investments. The ability to realize a substantial tax benefit after just three years provides a valuable new exit option, particularly in scenarios such as an early acquisition. The higher gain cap also makes larger-scale investments in promising ventures more appealing, as a greater portion of the potential return is shielded from tax. This could lead to a reevaluation of portfolio strategies, with greater emphasis on investing in domestic C corporations that are structured to qualify for QSBS benefits.

## IV. Additional Strategic Tax Provisions for Startups and Investors

Beyond the QSBS amendments, the OBBBA includes several critical tax revisions that directly and profoundly affect the operational and financial strategies of startups and investors. These provisions collectively create a more favorable environment for capital-intensive and R&D-focused businesses.

1. **Permanent Restoration of Immediate R&D Expensing:** The OBBBA permanently restores the ability for companies to immediately expense domestic R&D costs under a newly created IRC Section 174A, effective for tax years after December 31, 2024. This is a crucial reversal of the 2017 Tax Cuts and Jobs Act (TCJA) rule, which had required such costs to be amortized over five years, a provision that significantly hindered the cash flow of R&D-intensive startups. Immediate expensing is a powerful tool for reducing a company's tax burden and freeing up capital for reinvestment.

Moreover, the OBBBA includes a retroactive relief component. For companies that qualify as "small businesses" (generally those with average annual gross receipts under \$31 million), the law provides the option to amend their tax returns for the 2022, 2023, and 2024 tax years to retroactively deduct previously amortized R&D expenses. For larger businesses, an election is available to deduct any remaining unamortized domestic R&D expenses from those years either all at once in 2025 or ratably over the next two years. These provisions offer a substantial, immediate financial boost to startups.

2. **Permanent 100 Percent Bonus Depreciation:** The OBBBA revises IRC Section 168(k) and essentially makes the 100 percent bonus depreciation benefit permanent for qualified property acquired and placed in service after January 19, 2025. This means businesses can deduct the entire cost of qualifying assets in the year they are placed in service, rather than having to spread the deduction out over several years through regular depreciation schedules. This is a significant incentive for businesses that require substantial capital investment in tangible assets. "Qualified property" is defined broadly, encompassing most tangible personal property with a recovery period of 20 years or less, such as machinery, computers, and office equipment.

This provision also introduces a new, temporary 100 percent bonus depreciation for a category of "qualified production property" (QPP), which includes certain types of real property used in manufacturing or production activities. This specialized bonus depreciation, while temporary, is a targeted incentive to spur domestic manufacturing and production investment. By allowing for the immediate deduction of asset costs, the OBBBA accelerates tax savings – improving cash flow and encouraging startups to invest in the physical infrastructure necessary to scale.

3. **Relaxation of Business Interest Deduction Limitations:** The Act relaxes the IRC Section 163(j) limitation on the deductibility of business interest, a change effective for tax years beginning after 2024. The new rule reverts to a more favorable calculation, allowing companies to deduct business interest up to 30 percent of their earnings before interest, taxes, depreciation, and amortization (EBITDA), rather than the more restrictive taxable income calculation previously in effect.

This change is particularly beneficial for highly leveraged startups and growth-stage companies that rely on debt financing, as it expands their ability to deduct interest expenses. By making debt more tax efficient, the OBBBA lowers the effective cost of capital – potentially increasing the appeal of debt financing as a tool for growth and expansion.

4. **Permanent Extension of the Pass-Through Entity Deduction:** The OBBBA makes the 20 percent IRC Section 199A deduction for owners of pass-through entities (e.g., S corporations, partnerships,

and sole proprietorships) a permanent provision of the tax code. Previously, this provision was scheduled to expire at the end of 2025.

While the qualified business income (QBI) deduction rate remains at 20 percent, the Act makes several favorable adjustments. It increases the income phase-in thresholds, making the deduction available to a wider range of taxpayers. Previously, the QBI deduction started phasing out for single filers with taxable income more than \$197,300 and was eliminated once taxable income exceeded \$247,300 (for specified service trade or business owners). The OBBBA raised the phase-in threshold to \$250,525 (single filers) and expanded the phase-in range to \$75,000, meaning the deduction for specified service trade or business owners is not completely phased out until taxable income reaches \$325,525.

This change allows more high-income business owners to benefit from the QBI deduction or claim a larger deduction than they could under prior law. It also introduces a new minimum deduction of \$400 for taxpayers with at least \$1,000 of QBI, ensuring a baseline benefit. This permanency provides long-term certainty for investors and founders who utilize these popular entity structures and reinforces the tax parity between pass-through businesses and C corporations.

## IV. Conclusion

The OBBBA represents a comprehensive overhaul of the tax code. By enacting a suite of reforms – including the introduction of a tiered-gain exclusion system for QSBS, higher gain caps, expanded eligibility thresholds, permanent restoration of immediate R&D expensing, 100 percent bonus depreciation, relaxed business interest deduction limitations, and the permanent extension of the pass-through entity deduction – the OBBBA fundamentally reshapes the tax landscape for startups, investors, and the innovation economy as a whole.

Collectively, these provisions address longstanding barriers to growth, capital formation, and operational flexibility. They provide a more robust and adaptable framework that supports the varying needs of early-stage companies, high-growth ventures, and the investors who fuel their success. By modernizing key tax incentives and removing sources of uncertainty, the OBBBA empowers stakeholders to pursue ambitious strategies, accelerate innovation, and compete more effectively in a rapidly evolving marketplace.

If you have questions or need additional information, contact the authors or a member of Baker Donelson's [Business and Corporate Group](#) or [Tax Group](#).