

QSBS Rollovers

Most founders are familiar with Section 1202 of the Internal Revenue Code, which provides a tax exemption for the sale of Qualified Small Business Stock (QSBS). Less well known is Section 1202's cousin, Section 1045, which provides certain tax benefits for a "rollover" of proceeds from the sale of QSBS into replacement QSBS.

The basic rules are as follows:

- The original QSBS must be owned for at least 6 months prior to its sale.
- The proceeds of the sale of the original QSBS must be reinvested in replacement QSBS within 60 days of the sale of the original QSBS.
- The taxpayer elects rollover treatment for the sale of the original QSBS on his or her tax return for the year in which the original QSBS was sold.
- The taxpayer's gain on the sale of the original QSBS is deferred.
- The taxpayer's basis and holding period in the original QSBS that was sold carries over to the replacement QSBS.

By way of example, assume QSBS is held for three years and sold, and the proceeds are reinvested in new QSBS within 60 days. As a result, the gain on the sale of the original QSBS would not be realized (i.e., no capital gains tax would be due) and the replacement QSBS would only have to be held for two more years to meet the five-year holding period under Section 1202.

In the real world, the practical challenge of a rollover is usually timing. The timing of sale of private company stock can be unpredictable. The timing of an opportunity to invest in new QSBS also can be unpredictable. Only if the stars align and those two events both occur within 60 days can a founder take advantage of Section 1045.

One situation where Section 1045 may be far more useful is when a founder holds publicly traded QSBS. In that situation, sale of the original QSBS can be more easily timed to occur within 60 days of the acquisition of the replacement QSBS. For example, assume a founder's company goes public and the founder holds \$5,000,000 of QSBS that she acquired more than 5 years ago. (Also assume that the founder already took advantage of Section 1202 and previously sold \$10,000,000 of stock tax free.) The founder is an active angel investor, and every time she makes an angel investment, she sells \$50,000 of publicly traded QSBS and uses the proceeds within 60 days to acquire new QSBS. As a result, the founder (i) does not recognize gain on the sale of the publicly traded QSBS and (ii) immediately satisfies the 5-year holding period requirement with respect to the QSBS acquired. If that QSBS is later sold, the founder can take advantage of Section 1202 to receive up to \$10,000,000 proceeds tax free.

A rollover can also be combined with traditional QSBS "stacking" techniques. In the example above, the founder could make gifts of publicly traded QSBS to trusts for the benefit of her family members. Each trust, if properly structured, could sell the publicly traded QSBS and reinvest the proceeds in replacement QSBS with the same tax benefits outlined above.

If a serial entrepreneur is starting a new company, using rollover proceeds from the sale of QSBS to capitalize the new company will have similar tax benefits. In the example above, the founder (and trusts for her family members) could sell publicly traded QSBS and use the proceeds to acquire common stock in the new company. In certain circumstances, a [GOAT Trust](#) can also be combined with a rollover to provide additional tax benefits for the founder.

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