Maximizing IRC 1202 Tax Benefits: Stacking and Packing for QSBS Gains

A Powerful Tax Strategy for Business Owners

As a financial advisor, I am always looking for ways to help my clients **minimize taxes and preserve wealth**. One of the most powerful yet often overlooked tax benefits available today is **IRC Section 1202**, which governs **Qualified Small Business Stock (QSBS).**

When structured properly, IRC 1202 allows business owners to exclude up to $10 million—or 10 times their cost basis—from capital gains taxes when selling their business.

But did you know advanced strategies like "stacking" and "packing" can multiply these benefits and dramatically reduce tax liability?

Let's dive into how these strategies work and why they matter for you.

The History of Qualified Small Business Stock (QSBS) and IRC 1202

Congress created IRC 1202 in 1993 to encourage small business investment by offering a 50% capital gains exclusion.

- In 2009, the exclusion was increased to 75%.
- In 2010, the Small Business Jobs Act raised it to 100%.
- In 2015, the PATH Act made the 100% exclusion permanent

Here's what determines your exclusion rate:

- 50% exclusion: Stock acquired August 11,
- 1993 - February 17, 2009
- 75% exclusion: Stock acquired February 18, 2009 - September 27, 2010
- 100% exclusion: Stock acquired after September 27, 2010

To qualify, the stock must be held for at least five years.

Who Qualifies?

To be eligible, your business must be a C-corporation with assets under $50 million at the time of stock issuance.

Industries that typically qualify include:

- Technology & Software Development
- Manufacturing
- Wholesale/Retail
- Construction

However, certain service-based businesses do not

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qualify, including:

- Financial Services
- Healthcare Providers
- Professional Services (Law Firms, Consulting, Engineering)
- Any Business Where Employee Expertise is the Primary Asset

If your business engages in multiple activities, certain portions may qualify while others may not—making expert tax guidance essential.

Maximizing IRC 1202 Benefits: Stacking & Packing

If your business is worth $50 million, a traditional exit could result in significant capital gains tax.

But strategic QSBS planning can dramatically reduce or even eliminate those taxes.

Stacking: Multiplying the Exclusion Across Multiple Taxpayers

Stacking allows business owners to spread the $10 million QSBS exclusion across multiple taxpayers, increasing the total tax-free gain.

Example: Business Owner & Family Trusts

- A business owner and spouse create four irrevocable trusts for their children in tax-friendly states (e.g., Nevada, Wyoming).
- They gift $10 million in QSBS stock to each trust.
- By using IRC 2704, they apply a 30% valuation discount, meaning the total gift value for tax purposes is $7 million per trust—keeping it within the lifetime exemption.

The Result?

- The owner and spouse each qualify for $10 million in capital gains exclusion.
- The four trusts each qualify for $10 million in capital gains exclusion.
- If the business sells for $50 million, the entire amount could be tax-free.
- Plus, the growth of these completed gifts is outside the estate, avoiding estate taxes that could otherwise be 40% for assets above the lifetime exemption.

This means significant savings in capital gains tax, state income tax, and estate tax.

Packing: Increasing the QSBS Basis for a Higher Exclusion

While stacking spreads the exclusion across multiple taxpayers, packing increases the QSBS basis—allowing for a higher exclusion amount.

The goal is to increase the 10-times basis multiplier under IRC 1202.

Example: Packing in Action

- A business owner initially invests $1 million in QSBS.
- Over time, they contribute an additional $4 million in cash, equipment, and patents—all of which qualify under QSBS.
- Now, the QSBS basis is $5 million.
- Instead of a $10 million exclusion, the 10x basis rule now allows up to $50 million in tax-free

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capital gains.

Important Considerations

- Only specific types of contributions qualify (cash, property, patents).
- Stock received for services rendered does not qualify.
- Each contribution must meet QSBS requirements at the time it is made.
- The company's total assets must remain under $50 million.

Proper documentation and timing are crucial to ensure compliance.

The Power of Combining Stacking & Packing

When properly executed, stacking and packing together create an incredible tax-saving opportunity.

A business owner selling a $50 million company could potentially eliminate capital gains tax entirely, all while achieving important estate planning objectives.

As always, early planning and coordination with financial, tax, and legal professionals is key.

Beyond Tax Savings: Business Succession & Legacy Planning

While tax savings are the primary driver behind these strategies, the benefits go beyond taxes:

- Facilitating business succession planning
- Creating efficient wealth transfer strategies
- Protecting assets for future generations

Stacking and packing strategies allow business owners to reduce taxes, transfer wealth, and build a lasting financial legacy.

Closing Thoughts

By mastering IRC 1202 strategies, I can help you:

- Reduce or eliminate capital gains taxes when selling a business.
- Multiply tax-free gains through strategic trust planning.
- Optimize your estate planning while protecting generational wealth.

However, these strategies require early planning—they can't be implemented once a sale is already in motion.

That's why it's crucial to start the conversation now.

Let's Talk Strategy

To learn more about how to apply IRC 1202 strategies to your business, contact me today. I can provide a comprehensive guide and work with your tax and legal team to maximize your benefits.

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Investing in QSBS involves significant risks and potential loss of tax benefits. Qualification requirements are complex and ongoing, including active business, asset composition, and holding period criteria. The company must continuously meet the 80% active business test throughout the investor's holding period. Certain activities and industries are excluded, and exceeding size limitations can disqualify the stock. Early sale before the five-year holding period will result in loss of tax benefits. Insufficient documentation of QSBS status throughout the holding period may lead to disqualification upon IRS scrutiny.

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