

Tax & Business Alert

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TAKE ADVANTAGE OF EXPANDED QSB STOCK TAX BENEFITS

Investors often look to small, emerging companies for portfolio diversification and growth potential, but these investments can offer more. Certain shares may also provide valuable tax advantages under the qualified small business (QSB) stock rules. And last year's One Big Beautiful Bill Act (OBBBA) enhanced those benefits.

THE BASICS OF QSB STOCK

A QSB is a domestic C corporation that meets specific requirements. First, the company must be engaged in an active trade or business. Many professional service businesses are excluded, though certain health- and engineering-related companies may qualify, depending on the nature of their activities.

There's also a gross-asset limit. Before the OBBBA, a company's aggregate gross assets generally couldn't exceed \$50 million. The OBBBA increases the asset

ceiling to \$75 million (adjusted for inflation after 2026) for stock issued after July 4, 2025.

SHORTER HOLDING PERIODS

The major tax benefit of investing in QSB stock is the potential exclusion of capital gains when the stock is sold. Before the OBBBA changes went into effect, you generally needed to hold QSB stock for at least five years to qualify for a capital gains exclusion, with the exclusion percentage ranging from 50% to 100%, depending on when the stock was acquired.

Under the OBBBA, a new tiered system with smaller exclusions applies to QSB stock acquired after July 4, 2025. It provides a 50% exclusion for stock held for at least three years and a 75% exclusion for stock held for at least four years. Any gain not excluded under these partial exclusions is generally taxed at a special 28% federal rate, plus the 3.8% net investment income tax, if applicable.

QSB stock acquired on or before July 4, 2025, generally remains subject to the prior rules, including eligibility for a 100% exclusion after five years for stock acquired on or after September 28, 2010.

EXPANDED GAIN EXCLUSION LIMITS

The OBBBA also increased the limit on the amount of gain you can exclude. For QSB stock acquired after July 4, 2025, the per-issuer exclusion limit is the greater of \$15 million (adjusted for inflation after 2026) or 10 times the aggregate adjusted basis of stock sold during



the tax year. Before the OBBBA change went into effect, the dollar limit was \$10 million. (Both amounts are halved for married taxpayers filing separately.)

To qualify for the exclusion, you generally must acquire the stock at original issuance — directly from the corporation or through an underwriter — in exchange for cash, property (other than stock) or services. Limited exceptions apply, including certain transfers by gift or inheritance.

If you reinvest proceeds from a QSB stock sale into other QSB stock within 60 days, you may be able to

defer the gain until you dispose of the new stock. The rolled-over gain reduces your basis in the new stock. For determining long-term capital gains treatment, the new stock's holding period includes the holding period of the stock you sold.

MOVING FORWARD

QSB stock can offer valuable tax benefits. But the rules are complex and require careful planning. Additionally, some states don't conform to federal treatment, so state income taxes may still apply, depending on the state. Contact us if you have questions. ■

REDUCING IRS AUDIT RISK FOR SMALL BUSINESSES

When business owners think about risk, they often focus on market pressures or operational challenges. An IRS audit usually isn't top of mind — but it can be costly, disruptive and time-consuming. Although some taxpayers are randomly selected for an audit, many audits occur because the IRS has identified certain patterns or inconsistencies. Understanding where these risks typically arise can help you limit your business's exposure.

5 KEY AUDIT RISK AREAS

The following risk areas can result in additional IRS scrutiny:

1. Inconsistent or unreported income.

Drastic shifts in revenue from one year to the next can prompt IRS attention, especially when they conflict with industry trends or economic conditions. Income mismatches identified through third-party reporting — including 1099 forms and payment-platform data — may lead to follow-up inquiries. Accurate records are critical when income fluctuates significantly.

2. Excessive or unusual deductions. Deductions that appear disproportionate to income or far outside industry norms may raise IRS concerns. Only expenses that are “ordinary and necessary” for business operations are deductible. Personal expenses — including personal vehicle use, clothing and nonbusiness travel — are common audit issues. Careful records are especially important for meal, travel and vehicle-related deductions.

3. Repeated business losses. Consistently reporting losses may signal that a business isn't operated for profit. While legitimate losses occur — particularly during startup phases or



economic downturns — ongoing losses should be supported by strong documentation, financial planning and a clear profit motive.

4. Weak recordkeeping practices. Incomplete or disorganized records increase both audit risk and audit difficulty. Missing receipts, inconsistent financial statements or unclear bookkeeping practices can jeopardize deductions. Digital accounting tools make it easier and more defensible than ever to maintain accurate, well-organized records.

5. Worker misclassification. Misclassifying employees as contractors can result in back payroll taxes, penalties and interest. The key factor is the degree of control the business exercises over how the work is performed, not how the worker is paid or labeled.

STAYING AHEAD OF AUDIT RISK

No business is immune to audit risk, but consistent reporting, accurate records and informed guidance can significantly reduce exposure — and put your business in a better position if you *are* audited. We can help your business stay compliant, identify potential issues early and respond effectively if the IRS requests information. ■

HOW AN EDUCATIONAL ASSISTANCE PROGRAM CAN STRENGTHEN YOUR COMPANY'S BENEFITS PACKAGE

If your business is like many today, you're seeking more ways to attract and retain talent. One option is to offer tax-advantaged educational assistance under Internal Revenue Code Section 127. Recent legislative changes have expanded the value of this benefit.

HOW THE PLANS WORK

Employer-sponsored Sec. 127 educational assistance programs allow employees to receive tax-free educational benefits up to an annual limit (\$5,250 for 2026). The benefits are excluded from the employee's gross income for federal tax purposes. For employers, the amounts paid are deductible as business expenses.

But the plan doesn't have to be prefunded. You can pay or reimburse expenses as they're incurred.

Eligible expenses include tuition, books, fees, supplies and equipment for coursework. However, certain expenses, such as meals, lodging or transportation — as well as tools or supplies that employees retain after completing a course — don't qualify. Also ineligible are expenses for courses involving sports, games or hobbies unless they're required as part of a degree program.

When properly implemented, Sec. 127 plans can help you attract, develop and retain talent while delivering tax advantages.

To qualify as a Sec. 127 program, the plan must be established in writing and meet specific requirements. The plan can benefit only employees — not their spouses or dependents.

RECENT ENHANCEMENTS

The One Big Beautiful Bill Act (OBBBA), enacted on July 4, 2025, made two important changes to Sec. 127 plans. First, it introduced an inflation adjustment to the annual cap. For tax years beginning after 2026, the \$5,250 limit will be indexed for inflation (rounded down to the nearest \$50), helping maintain the benefit's value over time.

Second, the OBBBA made permanent the eligibility of employer payments for qualified student loans as a

Sec. 127 expense. This means you can pay up to the annual cap toward an employee's qualified student loan, and those payments will be excluded from the employee's income.



COMPLIANCE CONSIDERATIONS

Sec. 127 plans must follow additional rules. For example, you can't offer educational assistance as a choice between this tax-free benefit and taxable compensation, such as wages. And you must provide employees reasonable notice of the plan's availability and terms.

Additionally, nondiscrimination requirements and ownership-concentration limitations apply. For example, no more than 5% of total plan benefits for the year may be provided, in the aggregate, to employees who are more-than-5% owners of the business or to their spouses or dependents.

RULES FOR FAMILY EMPLOYEES

Sec. 127 plan benefits can extend to employees who are related to business owners, including children, as long as they're bona fide employees and the plan satisfies applicable nondiscrimination requirements and ownership-concentration limitations.

Ownership attribution rules may affect whether an individual is treated as a more-than-5% owner for these purposes, particularly in closely held businesses.

TAKING THE NEXT STEP

Properly implemented Sec. 127 plans can help employers attract, develop and retain talent. Contact us to discuss whether such a plan makes sense for your business. ■

GET AHEAD WITH A MIDYEAR TAX REVIEW

To help prevent surprises when you file your federal tax return next tax season, perform a midyear tax checkup. Life changes, such as a new job, additional side income or investment gains, can affect your tax picture more than you might expect. Taking time now to review key areas can reduce the risk of certain penalties and uncover tax savings opportunities.

Start by reviewing your withholding and estimated tax payments. If your income has changed, you may need to update your Form W-4 so that your withholding accurately reflects your current circumstances. If you're self-employed or have significant income not subject to withholding (such as dividends or capital gains), you may need to make quarterly estimated tax payments to avoid underpayment penalties.

Next, revisit deductions and credits. Changes in your filing status, dependents, education expenses or homeownership can affect eligibility. Additionally, increased charitable giving may create tax-saving opportunities. Keep organized records of charitable contributions, medical expenses, and, if you're

self-employed, business costs to substantiate claims and maximize benefits.



It's also a good time to reevaluate retirement contributions. Increasing contributions to employer plans or IRAs can reduce taxable income and strengthen long-term savings. If you're eligible to contribute to a Health Savings Account, consider funding it as well to take advantage of its triple tax benefits (deductible contributions, tax-deferred growth and tax-free withdrawals for qualified medical expenses).

Being proactive gives you time to manage potential tax exposure and identify tax-saving opportunities that might otherwise be overlooked. If you need guidance, we can help model different scenarios and determine the best strategy. ■

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