



## WHY YOUR PRACTICE EXIT WON'T QUALIFY FOR THE NEW QSBS TAX EXCLUSION – AND WHAT TO DO INSTEAD

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The One Big Beautiful Bill Act, signed into law on July 4, 2025, dramatically expanded the Section 1202 Qualified Small Business Stock benefit—raising the capital gains exclusion cap to \$15 million, shortening holding periods, and increasing the qualifying asset threshold to \$75 million. For technology founders and product-business owners, these changes represent significant potential tax benefits. But if you are a physician, attorney, CPA, or consultant, the **QSBS exclusion for professional services** means this benefit is categorically unavailable to your practice, and the capital gains taxes on your eventual exit remain fully intact.

That distinction leaves many of the highest-earning professionals in America on the outside of one of the most powerful tax provisions in the Internal Revenue Code, watching peers in other industries potentially sell businesses tax-free while their own practice exits face effective combined federal capital gains tax rates of 23.8% before state taxes.

This article explains why the QSBS exclusion for professional services exists, what the statutory requirements actually say, and—most importantly—the alternative investment strategies that can meaningfully reduce your tax exposure when the time comes to transition out of active practice. We encourage you to review these concepts with your tax advisors and legal counsel before making any planning decisions.

### **WHAT IS THE QSBS EXCLUSION, AND WHY HAS IT GENERATED SO MUCH ATTENTION?**

Qualified Small Business Stock (QSBS) is stock issued by a domestic C corporation that meets specific requirements under IRC Section 1202. When a non-corporate taxpayer sells QSBS held for the required period, they can exclude a substantial portion—up to 100%—of the resulting capital gain from federal income tax. This is, by a wide margin, one of the most valuable tax savings mechanisms available to business owners in America.

The One Big Beautiful Bill Act (OBBBA), effective July 4, 2025, enhanced this benefit in three significant ways for stock issued after that date:<sup>1</sup>

PROVISION	PRE-OBBBA (BEFORE JULY 4, 2025)	POST-OBBBA (AFTER JULY 4, 2025)
MAXIMUM GAIN EXCLUSION	\$10 million per taxpayer per issuer	\$15 million per taxpayer per issuer (indexed for inflation after 2026)
MINIMUM HOLDING PERIOD FOR FULL 100% EXCLUSION	More than 5 years	More than 5 years (with partial exclusions at 3 and 4 years)
GROSS ASSET THRESHOLD FOR ISSUING CORPORATION	\$50 million	\$75 million (indexed for inflation after 2026)
PROFESSIONAL SERVICE FIRMS ELIGIBLE?	No	Still No

The bottom row is the critical point. Congress expanded nearly every parameter of the QSBS benefit, but it did not change the list of excluded business categories. The QSBS exclusion for professional services remained exactly as it has been since 1993.

## HOW DOES QSBS QUALIFICATION WORK—AND WHERE DO PROFESSIONAL PRACTICES FAIL THE TEST?

Understanding why your practice is excluded requires a brief review of the Section 1202 qualification framework. QSBS eligibility operates at both the corporate level and the shareholder level, and every requirement must be satisfied simultaneously.

At the corporate level, the issuing entity must be a domestic C corporation. This is a threshold requirement that immediately eliminates many professional practices. If your practice operates as an **S corporation**, a partnership, or an LLC taxed as a partnership, it cannot issue Qualified Small Business Stock. An S corporation election permanently disqualifies stock issued during the election period, even if the entity later revokes its S election and converts to C corporation status.<sup>2</sup>

For practices that do operate as C corporations, the statute imposes a gross asset test: the corporation's aggregate gross assets cannot exceed \$75 million (for post-OBBBA stock) at any time before or immediately after the stock is issued. It also requires **original issuance**: the shareholder must acquire the stock directly from the corporation in exchange for money, property (other than stock), or services. Stock purchased from an existing shareholder on the secondary market does not qualify, regardless of how long it is held.<sup>3</sup>

Then comes the requirement that eliminates professional practices entirely. The corporation must conduct a **qualified trade or business**, defined in Section 1202 not by what qualifies, but by what does not. The statute requires that at least 80% of the corporation's assets be used in an **active trade or business** during substantially all of the shareholder's holding period (generally interpreted as 80% or more of the time the stock is held), and it explicitly excludes a lengthy list of service-oriented fields from the definition of a qualified trade or business.<sup>4</sup>

## WHY DOES THE QSBS EXCLUSION FOR PROFESSIONAL SERVICES EXIST?

The legislative rationale is rooted in how Congress views enterprise value. Section 1202 was designed to incentivize capital investment in businesses that create scalable, transferable economic value—enterprises where the worth resides in products, technology, processes, or intellectual property that can operate independently of the founders.

Professional service businesses, by contrast, derive most of their value from what the tax code calls “the reputation or skill of one or more employees.”<sup>5</sup> A physician practice’s revenue depends on the physicians who treat patients. A law firm’s billings depend on the attorneys who serve clients. When those professionals depart, a significant portion of the enterprise value typically departs with them. Congress concluded that this type of trade or business does not generate the kind of independently transferable economic activity that Section 1202 was designed to reward.

IRC §1202(e)(3) explicitly enumerates the excluded fields: health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, and brokerage services. This is not an ambiguity in the statute. It is a categorical exclusion that applies regardless of entity structure, practice size, or revenue model.<sup>6</sup>

Importantly, Holland & Knight noted in their July 2025 analysis that the IRS has not yet issued comprehensive regulations defining the precise contours of terms like “health services” under Section 1202.<sup>7</sup> This means certain healthcare-adjacent businesses—such as health technology SaaS platforms or medical device companies that do not themselves perform professional services—may occupy a gray area. But if your practice revenue derives primarily from licensed practitioners delivering professional services, your tax advisors should confirm that the exclusion applies unambiguously.

## WHAT DOES A TAXABLE PRACTICE EXIT ACTUALLY COST IN CAPITAL GAINS TAXES?

Without the Section 1202 exclusion, the sale of a professional practice is generally treated as a capital gains event. At current federal rates, long-term capital gains taxes are assessed at a maximum rate of 20% for high earners, plus the 3.8% Net Investment Income Tax (NIIT) under IRC §1411, producing a combined federal rate of 23.8%. State income taxes, where applicable, compound this further. Texas residents benefit from no state income tax—a meaningful advantage for professionals in the Palmer Wealth Group service area—but those in California, New York, or New Jersey face materially higher effective rates.<sup>8</sup>

Consider a practical illustration. A physician practice owner sells a medical group for \$6 million, with an adjusted cost basis of \$500,000. *(This is a hypothetical scenario for illustrative purposes only. Actual tax outcomes depend on individual circumstances, transaction structure, applicable state taxes, and other factors.)*

Without QSBS (Professional Practice)	With QSBS (Eligible Tech Company)
Sale price: \$6,000,000	Sale price: \$6,000,000
Cost basis: \$500,000	Cost basis: \$500,000
Taxable gain: \$5,500,000	Taxable gain: \$5,500,000
<b>Federal capital gains taxes (23.8%): ~\$1,309,000</b>	<b>Federal capital gains taxes (100% excluded): \$0</b>
Net after federal tax: ~\$4,691,000	Net after federal tax: \$6,000,000

The difference—more than \$1.3 million in tax savings in this simplified scenario—illustrates why QSBS-eligible business owners celebrate the OBBBA changes, and why professional practice owners need an entirely different playbook.

## **CAN A SECTION 1045 ROLLOVER HELP IF MY PRACTICE DOESN'T QUALIFY?**

Some practice owners who also hold equity in QSBS-eligible companies ask whether the **Section 1045 rollover** provision can bridge the gap. Section 1045 allows a taxpayer who sells QSBS before satisfying the full holding period to defer the resulting gain by reinvesting the proceeds into new QSBS within 60 days.<sup>9</sup> The holding period of the original stock “tacks on” to the replacement stock, preserving progress toward the full five-year threshold.

However, the Section 1045 rollover does not solve the fundamental problem for professional service practices. It is a tool for shareholders who already hold qualifying QSBS, enabling them to reinvest before the holding period is complete. If the underlying trade or business falls within the excluded professional services categories, no stock from that business will ever qualify as QSBS, and Section 1045 is irrelevant to the practice sale itself.

That said, if you have investment interests in other C corporations that *do* meet the qualified trade or business test—a technology startup, a product company, or a manufacturing venture—the Section 1045 rollover may be a valuable component of your broader portfolio tax strategy. This is a nuance worth discussing with your tax advisors, particularly if you hold equity positions across multiple businesses.

## **FIVE ALTERNATIVE INVESTMENT STRATEGIES FOR A TAX-EFFICIENT PRACTICE EXIT**

Because the QSBS exclusion for professional services is a statutory barrier, not a planning failure, the appropriate response is a disciplined pivot to the other mechanisms the tax code provides. Each of the following strategies can reduce, defer, or restructure the capital gains taxes from a practice sale, though each also carries its own risks, costs, and limitations. No strategy eliminates tax liability entirely, and outcomes depend on individual circumstances. The right combination depends on your financial situation, timeline, post-exit income needs, and philanthropic goals. Your tax advisors, financial planner, and estate attorney should evaluate these options as an integrated framework, not in isolation.

### **1. *Installment Sales Under IRC Section 453***

An installment sale is the most straightforward tax deferral mechanism available for a practice exit. Rather than receiving the full sale price at closing, the seller accepts payments over multiple years, recognizing capital gain only as each payment is received.<sup>10</sup>

For a \$6 million practice sale structured as a ten-year installment, approximately \$600,000 per year would be received, with capital gains taxes assessed only on each year's gain portion as determined by the gross profit percentage. This approach can smooth taxable income across the transition into retirement, keep the seller in more favorable tax brackets in states with graduated rates, and maintain a steady income stream during the years when post-practice revenue is being established.

The primary risk is buyer default. Because the seller effectively extends credit to the buyer, the strength of the buyer's financial position and the terms of the promissory note are critical considerations. Interest

rates on installment notes must meet or exceed the Applicable Federal Rate to avoid imputed interest complications. Your tax advisors should model the interaction between installment income, NIIT thresholds, and any other income sources during the payout period.

## **2. Charitable Remainder Trusts for Philanthropic Practice Owners**

A Charitable Remainder Trust (CRT) allows a practice owner to transfer appreciated business interests to an irrevocable trust before the sale. The trust then sells the assets without incurring immediate capital gains taxes, invests the proceeds, and pays the donor an income stream for life or a specified term. The remaining trust assets pass to a designated charity when the trust terminates.<sup>11</sup>

This approach provides three simultaneous benefits: deferral of capital gains taxes, an upfront charitable income tax deduction based on the present value of the charitable remainder interest, and a structured income stream during retirement. The IRS requires that the annuity or unitrust payout be at least 5% and no more than 50% of the initial trust value, and the remainder interest must represent at least 10% of the initial contribution. The potential tax benefits may be significant, though they come with the irrevocable commitment of the remainder to charity.

For practice owners with established philanthropic commitments, CRTs align tax-deferred practice sale objectives with legacy goals. We explored the broader charitable tax landscape in our recent analysis of [how the One Big Beautiful Bill Act reshaped charitable deduction rules](#), including the new 0.5% AGI floor on charitable deductions that took effect January 1, 2026.

## **3. Qualified Opportunity Zone Deferrals**

Under IRC Section 1400Z-2, capital gains from a practice sale can be deferred by reinvesting the gain into a Qualified Opportunity Zone (QOZ) Fund within 180 days of the recognition event. While the original deferral and partial exclusion benefits from the 2017 Tax Cuts and Jobs Act have been modified, the OBBBA enhanced the program for rural Qualified Opportunity Zones, reducing the substantial improvement threshold from 100% to 50% for qualifying rural properties, effective July 4, 2025.<sup>12</sup>

The limitation is geographic and structural specificity. QOZ investments must be made in designated census tracts, and the underlying investment must meet active trade or business or real property requirements. This strategy works best when the practice owner has a genuine interest in real estate development or business investment in qualifying areas, not as a pure tax-avoidance mechanism. The investment risk is real, the capital is illiquid for the duration of the deferral period, and the tax savings must be weighed against the opportunity cost and concentration risk of a geographically constrained investment.

## **4. Structured Earnouts and Deferred Compensation Arrangements**

Many professional practice sales—particularly to private equity platforms or hospital systems—now involve hybrid structures where a portion of the purchase price is received at closing and the remainder is paid as earnout compensation tied to post-sale performance metrics.<sup>13</sup>

Medical Economics reported in late 2025 that PE-backed buyers are increasingly requiring physician sellers to accept a larger share of total consideration through rollover equity and performance-based earnouts, with less cash paid at closing. While this trend reflects tighter credit conditions, it can also create tax planning opportunities: earnout payments structured as ordinary compensation may be offset by retirement plan contributions, including the cash balance plan structures discussed in our guide to [how](#)

[physicians can maximize retirement savings beyond the 401\(k\)](#). A well-designed cash balance plan may permit annual tax-deferred contributions that can exceed \$300,000 for professionals over age 50, depending on plan design and individual factors, partially sheltering earnout income from immediate taxation and potentially producing meaningful tax savings over the earnout period.

### **5. Coordinated Multi-Strategy Exit Design**

In practice, the most effective exit plans for professionals navigating the QSBS exclusion for professional services rarely rely on a single mechanism. A well-designed exit may combine an installment sale for the core practice assets, a charitable remainder trust for a portion of appreciated real estate or investments held within the practice, an Opportunity Zone deferral for a targeted portion of gain, and a deferred compensation arrangement for post-transition consulting services.

This layered approach is precisely where the coordination advantage of an ensemble advisory model becomes critical. When your financial advisor, tax advisors, estate attorney, and insurance specialist are operating in concert—rather than in silos—the interaction effects between strategies can be modeled, stress-tested, and optimized before the first document is signed. An installment sale affects your income tax bracket. A CRT affects your estate plan. An Opportunity Zone deferral affects your liquidity timeline. Evaluating any single strategy without modeling its downstream effects on the rest of your plan can produce expensive, unintended consequences.

For a deeper discussion of how coordinated exit planning maximizes transferable enterprise value, see our article on [strategies for successful business transition planning](#).

## **WHAT MISTAKES SHOULD PROFESSIONAL PRACTICE OWNERS AVOID WHEN PLANNING AN EXIT?**

Based on patterns we observe across our client base, four errors recur with concerning frequency:

- **Waiting too long to begin.** Asset protection strategies, entity restructuring, and trust formation all require implementation well in advance of a sale. Structures established after a transaction is underway may be challenged as fraudulent transfers or disregarded for tax purposes. The optimal planning horizon for a practice exit is three to five years before the anticipated sale date.
- **Assuming QSBS eligibility without verification.** We periodically encounter practice owners who have been told by well-meaning but misinformed advisors that their practice may qualify for the Section 1202 exclusion. The statutory language is unambiguous: practices operating a trade or business in health, law, accounting, consulting, and the other enumerated fields are excluded from the definition of a qualified trade or business regardless of entity structure, revenue model, or operational characteristics. If your practice is structured as an S corporation, the disqualification is even more absolute; S corporation stock is permanently ineligible for QSBS treatment during the period the S election is in effect.
- **Confusing entity conversion with QSBS eligibility.** Some advisors suggest converting an S corporation or LLC to a C corporation as a path to QSBS eligibility. While this conversion can create newly issued stock that technically meets the original issuance requirement, it does not change the underlying trade or business classification. If the C corporation continues to operate in an excluded professional services field, no stock it issues—regardless of when or how it is issued—will qualify as QSBS. The active trade or business test and the excluded-services list are independent of the entity's corporate form.

- **Evaluating strategies in isolation.** Each of the strategies above interacts with your broader financial picture. Coordinated modeling across tax, estate, cash flow, and risk dimensions is not optional for practice owners in the \$5–30 million wealth range. It is the difference between an adequate exit and an optimized one, and it requires a team of advisors accustomed to working together, not in parallel.

## KEY TAKEAWAYS FOR YOUR PLANNING

- The QSBS exclusion for professional services is statutory and categorical. Practices operating a trade or business in health, law, accounting, consulting, financial services, and other enumerated fields cannot issue Qualified Small Business Stock under IRC §1202. The OBBBA did not change this exclusion. S corporation structures are independently disqualifying.
- The enhanced QSBS benefit (up to \$15 million in tax-free capital gains for stock issued after July 4, 2025, with tiered partial exclusions at three- and four-year holding periods) applies only to eligible C corporations conducting a qualified trade or business in non-excluded industries. The Section 1045 rollover provision is relevant only to shareholders who already hold qualifying QSBS.
- Five alternative investment strategies for reducing capital gains taxes on practice exits—installment sales, charitable remainder trusts, Qualified Opportunity Zone deferrals, structured earnouts, and multi-strategy coordination—each offer meaningful potential tax savings with distinct trade-offs in liquidity, complexity, and planning horizon.
- Begin exit planning three to five years before your anticipated transition. Confirm the original issuance requirements, entity structure, and trade or business classification with your tax advisors before relying on any QSBS-adjacent strategy.
- Coordinated advisory teams—financial planner, tax advisors, estate attorney, and insurance specialist working in concert—are positioned to deliver better outcomes than fragmented, single-advisor approaches to practice exit design.

## Important Disclosures

*This article is provided for informational and educational purposes only and does not constitute personalized investment, tax, or legal advice. The strategies discussed involve varying degrees of complexity, risk, and cost. All investment strategies carry the potential for loss, and there is no guarantee that any specific strategy will achieve its intended tax savings or other objectives. Past performance of any investment strategy does not guarantee future results. Tax laws and regulations are subject to change, and the application of any strategy depends on individual circumstances that require professional evaluation. Readers should consult with qualified financial, tax, and legal professionals before implementing any of the approaches described in this article.*

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## References

1. One Big Beautiful Bill Act, P.L. 119-21, §70106 (signed July 4, 2025). Amended IRC §1202 to increase gain exclusion cap to \$15 million, raise gross asset threshold to \$75 million, introduce tiered holding periods (50% at 3 years, 75% at 4 years, 100% at 5+ years) for stock issued after July 4, 2025, and index both thresholds for inflation beginning 2027.
2. IRC §1202(c)(1)(A) requires the issuing entity to be a domestic C corporation. Stock issued by an S corporation during the period its S election is in effect is permanently ineligible for QSBS treatment, even if the entity subsequently revokes the election and converts to C corporation status.
3. IRC §1202(c)(1)(B). The original issuance requirement mandates that QSBS be acquired directly from the corporation in exchange for money, property (other than stock), or services. Stock acquired from existing shareholders does not qualify.

4. IRC §1202(e)(1)(A). Requires that during substantially all of the taxpayer's holding period, at least 80% of the corporation's assets (by value) be used in the active conduct of one or more qualified trades or businesses.
5. IRC §1202(e)(3), cross-referencing §448(d)(2) regarding personal service corporations. Defines excluded businesses as those in which "the principal asset is the reputation or skill of one or more employees."
6. IRC §1202(e)(3). Lists health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, and brokerage services as ineligible business categories for QSBS purposes.
7. Holland & Knight LLP, "One Big Beautiful Bill Act Increases Tax Benefits for Qualified Small Business Stock," July 2025. Noted that "no comprehensive regulations specific to Code Section 1202 have yet been issued on the business activity requirements (e.g., the precise contours of what constitutes 'health services')."
8. IRC §1(h) (20% maximum long-term capital gains rate for taxpayers in the highest bracket); IRC §1411 (3.8% Net Investment Income Tax on modified adjusted gross income exceeding \$250,000 for joint filers, \$200,000 for single filers).
9. IRC §1045. Permits a taxpayer who sells QSBS held for more than six months to defer gain by purchasing replacement QSBS within 60 days. The holding period of the original stock tacks onto the replacement stock. See also McLane Middleton, "OBCCA Changes to the QSBS Regime Under Section 1202: A Comprehensive Overview," February 2026.
10. IRC §453. The installment sales method permits recognition of gain proportionally as payments are received. The gross profit percentage (gain divided by total sale price) determines the taxable portion of each payment. Special rules apply to dealer dispositions and related-party transactions.
11. IRC §664, 170. Charitable remainder trusts provide an income stream to the donor, defer capital gains recognition when the trust sells contributed assets, and generate a charitable income tax deduction based on the present value of the remainder interest. The trust must pay at least 5% and no more than 50% annually, and the remainder must equal at least 10% of initial contribution value. IRS Revenue Procedures 2003-53 through 2003-60 provide sample trust forms.
12. IRC §1400Z-2; IRS Notice 2025-96 and related Opportunity Zone guidance published pursuant to the OBCCA. The Act reduced the substantial improvement threshold from 100% to 50% for property located entirely in rural Qualified Opportunity Zones, effective July 4, 2025.
13. Medical Economics, "Trends in Buying and Selling Medical Practices," December 28, 2025. Reported that PE-backed buyers are requiring physician practice sellers to accept a larger percentage of purchase price through rollover equity units and performance-based earnouts, with reduced cash at closing.

**Research Methodology:** This article was prepared using AI-assisted research and drafting tools. All regulatory citations, statistical references, and compliance-related content were verified against primary sources by Palmer Wealth Group™ professionals.

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