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A GUIDE FOR FOUNDERS AND THEIR ADVISORS

What is trust stacking, and why should a busy founder take the time to consider it?

How founders can multiply a federal tax break on startup stock, and why it pays to act before the company's value increases too much.

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INSIDE

01 Common questions
02 QSBS in plain English
03 Why trusts multiply the benefit
04 The founder who set up three trusts early
05 Getting the trust design right
06 Why it pays to act early
07 What to do now

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Common questions

> Can a trust get its own QSBS exclusion?
>
> Does a spouse get a separate QSBS cap?
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> When should a founder set up trusts for QSBS?
>
> Can a founder give shares to a trust right before their company is acquired?

The biggest planning wins for founders and early employees happen in the early days, before the company's value increases too much. Some repeat founders know this playbook and others get turned on to it through their social network. However, the vast majority are understandably so focused on getting their business off the ground that they never take the time to optimize their own personal situation.

This paper is about one of those potential planning wins. A federal tax break for startup stock, known as QSBS, can make gain on a sale free of federal income tax, up to the greater of $15 million or 10 times what you paid for the stock, if certain conditions are met. That limit applies per taxpayer, and a properly formed and administered trust is its own taxpayer. So a founder who moves some shares into the right trusts early can multiply the amount that is exempt from federal income tax, and move future growth out of their taxable estate at the same time. While this might be the last thing on most founders' minds, it can save them millions of dollars in federal income and estate tax when they ultimately sell their company.

QSBS in plain English

"Qualified small business stock" (QSBS) is stock in a young U.S. C corporation (the standard corporate form venture investors back) that you received directly from the company. If you hold it long enough and the company meets the requirements, some or all of your gain on a sale is excluded from federal income tax under Section 1202 of the Internal Revenue Code.

For stock issued after July 4, 2025, when Congress expanded the rules in the One Big Beautiful Bill Act, the key numbers are:

RULE	WHAT IT MEANS
Holding period	50% of eligible gain excluded after 3 years, 75% after 4 years, 100% after 5 years
Cap per taxpayer	The greater of $15 million or 10 times your basis (your cost in the stock); the $15 million rises with inflation after 2026
Company size requirement	The company's gross assets (roughly, cash plus the tax value of what it owns) must stay at $75 million or less up to and right after the stock is issued to be QSBS-eligible

Stock issued on or before July 4, 2025 follows the older rules: a $10 million cap and no exclusion until the stock is held for more than 5 years.

The company also has to qualify. At least 80% of the company's assets must be used in an active business, and certain service fields are excluded, including law, health, consulting, financial services, and any business whose main asset is the reputation or skill of its employees. Founders should confirm that they meet these requirements with counsel before building a plan around QSBS.

WHAT TO DO NOW
STEP 1

Confirm the company qualifies. Check the C corp status, the $75 million gross-asset limit, and the excluded-business list with corporate counsel.

California does not follow QSBS. California repealed its own version in 2013 after a court struck down its in-state requirements, so California residents pay full state income tax on

QSBS gain. The planning below saves federal tax; the trust section explains how trusts can also limit California tax in some cases.

Why trusts multiply the benefit

The $15 million cap applies to each taxpayer, per company. When you give QSBS away, the person or trust receiving it is treated as having acquired it the same way you did, and inherits your holding period. So each recipient that is a separate taxpayer brings its own $15 million cap. Planners call this "stacking."

WHAT TO DO NOW
STEP 2

Decide how many caps are worth building. Weigh the likely exit against the cost of setting up and running each trust.

Two limits shape who can be a recipient:

- **Your spouse doesn't add a cap.** A married couple filing jointly shares one cap, split between them.
- **Many trusts don't count as separate.** The IRS treats a "grantor trust" as the founder for income tax purposes. A trust is a grantor trust when the founder (the "grantor," who creates and funds it) keeps certain powers or benefits, such as the power to swap assets in and out of the trust, or the ability to have trust income paid to a spouse. The founder/grantor then reports the trust's income and pays its tax, and its shares count against the founder's own QSBS cap. Only a "non-grantor" trust, which files and pays tax on its own, gets a separate cap.

ILLUSTRATIVE SCENARIO

The founder who set up three trusts early

A founder owns stock with a near-zero basis. Early on, while the shares are worth little, she gives 15% of her shares to each of three non-grantor trusts, one for each of her children. Years later the company sells, and her original stake is worth $100 million.

	NO TRUSTS	THREE TRUSTS
Founder's gain	$100M	$55M
Each trust's gain	None	$15M
Gain excluded from federal tax	$15M	$60M (founder $15M + 3 trusts at $15M)
Gain taxed	$85M	$40M
Federal tax at 23.8%*	**About $20.2M**	**About $9.5M**

The trusts save about $10.7 million of federal income tax.

The $45 million they hold is also outside the founder's estate, which can avoid federal estate tax of up to 40% on that amount if her estate would otherwise exceed the exemption. That exemption is the amount each person can give away during life or leave at death free of federal gift and estate tax: $15 million in 2026, with only the excess taxed.

*20% long-term capital gains rate plus the 3.8% tax on investment income.
Illustrative only: assumes all stock was issued after July 4, 2025 and held 5+ years, and ignores state tax and dilution.

Getting the trust design right

The trusts that stack QSBS are irrevocable, non-grantor trusts, usually set up for children or other descendants. The design choices below decide whether they work.

- **Non-grantor status.** A trust is a grantor trust if the founder keeps certain powers or benefits, including any trust whose income can go to the founder's spouse. That rules out a common family planning trust, the spousal lifetime access trust (SLAT), for stacking. A SLAT can still be useful for estate tax, but its shares count against the founder's cap. A typical example of a non-grantor trust is an irrevocable trust for the founder's children, run by an independent trustee, where neither the founder nor the spouse can benefit, borrow, swap assets, or control distributions.
- **Establishing real differences between trusts.** Section 643(f) of the tax code (an anti-abuse rule) lets the IRS treat two or more trusts as one if they have substantially the same grantor and beneficiaries and a principal purpose of the trust is to avoid tax. Spouses count as one person under this rule. Separate trusts for different children, with different terms, are the usual answer.
- **Dynasty design.** Many founders make these trusts long-lasting "dynasty" trusts and allocate their generation-skipping transfer (GST) tax exemption to them. The GST exemption is a separate allowance in the same amount as the estate tax exemption, $15 million per person in 2026, and is usually applied to the same gifts. Together, they let the shares and their growth pass to grandchildren and later generations without estate tax at each generation. Because startup shares are often worth very little when they're given, the gift uses very little of either exemption, yet the shares can grow dramatically over decades without incurring estate or GST tax.
- **Trust taxes.** A non-grantor trust pays its own tax, and trusts reach the top 37% bracket at just $16,000 of income in 2026. That matters little for QSBS gain that is fully excluded, but it matters for gain above the cap and for other income the trust earns.
- **California.** For a nongrantor trust, California taxes income that does not come from California sources based on where the trustees live and where any beneficiary with a non-contingent interest lives, not where the settlor lives. Income from California sources, such as gain on California real estate or a California business, is taxable regardless of where the trustees and beneficiaries live. Choosing trustees who live and administer the trust outside California, and giving California family members only discretionary interests (the trustee alone decides whether and when they receive anything), can generally keep California from taxing non-California gain while it stays in the trust. California can still tax that gain later, when the trust distributes it to a beneficiary who lived in California while the gain accumulated. Since the 2023 tax year, California also treats "incomplete gift non-grantor" (ING) trusts, a popular tool for avoiding state tax, as grantor trusts for California purposes when the grantor is a California resident, with an exception for trusts that distribute substantially all income to charity. California counsel should confirm each trust's state treatment.

WHAT TO DO NOW
STEP 3

Set up the trusts before value builds. Use separate non-grantor trusts with distinct beneficiaries and terms, and consider out-of-state trustees.

Why it pays to act early

Timing drives almost everything here.

- **Gifts are valued when made.** A gift uses up the founder's lifetime gift tax exemption ($15 million per person in 2026) at the shares' value on the day of the gift, not at the exit. Shares worth $300,000 at founding that grow to $45 million use only $300,000 of exemption. The same gift a year before a sale could use most of the exemption. The founder reports the gift on a gift tax return (Form 709), and a defensible appraisal or 409A valuation (the independent appraisal startups use to price stock options) supports the value.
- **The holding period carries over.** A trust that receives shares from a founder inherits that founder's holding period, so an early gift loses no time toward the 3-, 4-, and 5-year milestones.
- **Late gifts can fail.** Once a sale is effectively certain, the gain can be taxed to the donor anyway. In *Ferguson v. Commissioner*, donors who gave stock to charity during a pending

WHAT TO DO NOW
STEP 4

Make the gifts early. Get an appraisal, file Form 709, and allocate GST exemption where it fits.

tender offer were taxed on the gain because their right to the sale proceeds had already "ripened." Gifts made well before any deal talks avoid that risk.

- **The cost of waiting compounds.** Every financing round raises the share value, so each round makes the same gift more expensive in exemption.

What to do now

1. **Confirm the company qualifies.** Check the C corp status, the $75 million gross-asset limit, and the excluded-business list with corporate counsel.
2. **Decide how many caps are worth building.** Weigh the likely exit against the cost of setting up and running each trust.
3. **Set up the trusts before value builds.** Use separate non-grantor trusts with distinct beneficiaries and terms, and consider out-of-state trustees.
4. **Make the gifts early.** Get an appraisal, file Form 709, and allocate GST exemption where it fits.
5. **Keep the records.** Hold onto stock certificates, gift returns, and the company's annual QSBS records; these prove the exclusion at exit.

Jay Law can help design and set up these trusts alongside your corporate and tax advisors. If you're interested in learning more, contact us at jaylaw.co.

ABOUT THE AUTHOR

Travis Neal is the Founding Partner of Jay Law, P.C. He has practiced trusts and estates in the Bay Area for almost 20 years, most recently as a partner at a boutique trusts and estates firm, and has been licensed in California since 2007.

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