Illinois vs. Its Midwest Competitors: Who Is Taxing Startup Investment?

Legislative fact sheet — 2026 | Qualified Small Business Stock (QSBS), IRC §1202

KEY POINT: Illinois now requires federally excluded QSBS gains to be added back to Illinois income for tax years beginning in 2026.

What changed?

The 2025 federal One Big Beautiful Bill Act (OBBBA) expanded IRC §1202 for qualifying stock issued after July 4, 2025. The federal rules now provide a 50% exclusion after 3 years, 75% after 4 years, and 100% after 5 years; the per-issuer exclusion limit increased to $15 million (indexed) or 10× basis, whichever is greater; and the qualifying-business gross-assets threshold increased from $50 million to $75 million.

Illinois SB 3019 takes the opposite approach. Illinois Department of Revenue states that for tax years ending on or after December 31, 2026, Illinois decouples from IRC §1202 and requires federally excluded QSBS gains to be added back to Illinois base income.

Midwest comparison

State	2026 state treatment of QSBS	Treatment of 2025 federal expansion	Illustrative state tax on $10M federally excluded gain
Illinois	**Decouples from §1202**; federally excluded gain added back.	**Does not conform.**	**$495,000** at 4.95%
Indiana	Conforms to §1202.	**Adopted** through updated federal conformity.	$0
Wisconsin	Conforms to §1202.	**Adopted**; Wisconsin updated guidance for OBBBA QSBS changes.	$0
Michigan	Conforms to §1202.	**Conforms** under rolling conformity.	$0
Missouri	Conforms to §1202.	**Conforms** under rolling conformity.	$0
Ohio	Conforms to §1202.	**Conforms**; 2026 conformity legislation updated Ohio's IRC conformity.	$0
Iowa	Conforms to §1202.	**Expansion not yet confirmed** in the June 2026 state conformity review.	Depends on whether 2025 expansion is adopted
Minnesota	Conforms to §1202 generally.	**Expansion not yet confirmed** in the June 2026 state conformity review.	Depends on whether 2025 expansion is adopted

Why the Illinois difference matters

For a qualifying investor who realizes a $10 million gain that is fully excluded federally, Illinois' 4.95% individual income-tax rate would produce approximately **$495,000** of Illinois tax under the new add-back rule. At $5 million and $15 million, the same simple illustration is approximately $247,500 and $742,500, respectively.

Economic-policy implication: Federal law is designed to encourage investment in qualifying startups and small businesses. Illinois' SB 3019 instead creates a state-level tax on gains that federal law excludes. That can make Illinois less tax-competitive than Midwestern states that continue to recognize the federal QSBS benefit.

Important qualification

State conformity is not identical to adoption of every new federal QSBS provision. Iowa and Minnesota require particular caution because the June 2026 conformity review identified their adoption of the 2025 QSBS expansion as unresolved/pending. The table therefore distinguishes the underlying §1202 treatment from adoption of the new federal expansion.

Sources: Illinois Department of Revenue, FY 2027-01 (2026 income-tax changes); Wisconsin Department of Revenue, 2025 Tax Update; Ohio Department of Taxation, Ohio Conformity Updates; Indiana SB 243 / RSM US analysis; Council of State Governments Midwest, "Conform or decouple?" (July 8, 2026); CTA Acquisitions, State QSBS Conformity Matrix (June 22, 2026); American Bar Association Tax Section, "Qualified Small Business Stock Post-OBBBA" (May 2026).

Prepared for legislative/policy discussion. Not tax advice. State tax outcomes can vary by taxpayer, entity, residency, holding period, issuance date, and other QSBS requirements. Information current as of August 28, 2026.