

Introduced by Senator Gaines

February 17, 2011

An act to amend Sections 18152 and 18152.5 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

SB 556, as introduced, Gaines. Income taxes: federal conformity: Creating Small Business Jobs Act of 2010.

The Personal Income Tax Law in modified conformity with federal income tax laws provides that gross income does not include 50% of any gain from the sale or exchange of qualified small business stock, as defined, held for more than 5 years, as provided.

This bill, under the Personal Income Tax Law, would conform with federal income tax law, as that law was amended by the Creating Small Business Jobs Act of 2010, providing that gross income does not include 100% of any gain from the sale or exchange of qualified small business stock, acquired in the 2011 calendar year, held for more than 5 years, as provided.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 18152 of the Revenue and Taxation Code
- 2 is amended to read:
- 3 18152. (a) *Except as provided in subdivision (c)*, Section 1202
- 4 of the Internal Revenue Code, relating to 50-percent exclusion for
- 5 gain from certain small business stock, shall not apply.

1 (b) ~~Any~~ Except as provided in subdivision (c), any reference in
2 the Internal Revenue Code to the “exclusion allowed under Section
3 1202” shall, for purposes of this part, be modified to refer to the
4 exclusion allowed under Section 18152.5.

5 (c) In the case of qualified small business stock acquired during
6 the 2011 calendar year, Section 1202(a)(4) of the Internal Revenue
7 Code, relating to 100 percent exclusion of stock acquired during
8 certain periods in 2010 and 2011, shall apply.

9 SEC. 2. Section 18152.5 of the Revenue and Taxation Code
10 is amended to read:

11 18152.5. (a) ~~For~~ Except as provided in subdivision (c) of
12 Section 18152, for purposes of this part, gross income shall not
13 include 50 percent of any gain from the sale or exchange of
14 qualified small business stock held for more than five years.

15 (b) (1) If the taxpayer has eligible gain for the taxable year
16 from one or more dispositions of stock issued by any corporation,
17 the aggregate amount of the gain from dispositions of stock issued
18 by the corporation which may be taken into account under
19 subdivision (a) for the taxable year shall not exceed the greater of
20 either of the following:

21 (A) Ten million dollars (\$10,000,000) reduced by the aggregate
22 amount of eligible gain taken into account by the taxpayer under
23 subdivision (a) for prior taxable years and attributable to
24 dispositions of stock issued by the corporation.

25 (B) Ten times the aggregate adjusted bases of qualified small
26 business stock issued by the corporation and disposed of by the
27 taxpayer during the taxable year. For purposes of subparagraph
28 (B), the adjusted basis of any stock shall be determined without
29 regard to any addition to basis after the date on which the stock
30 was originally issued.

31 (2) For purposes of this subdivision, the term “eligible gain”
32 means any gain from the sale or exchange of qualified small
33 business stock held for more than five years.

34 (3) (A) In the case of a married individual filing a separate
35 return, subparagraph (A) of paragraph (1) shall be applied by
36 substituting five million dollars (\$5,000,000) for ten million dollars
37 (\$10,000,000).

38 (B) In the case of a married taxpayer filing a joint return, the
39 amount of gain taken into account under subdivision (a) shall be

1 allocated equally between the spouses for purposes of applying
2 this subdivision to subsequent taxable years.

3 (C) For purposes of this subdivision, marital status shall be
4 determined under Section 7703 of the Internal Revenue Code.

5 (c) For purposes of this section:

6 (1) Except as otherwise provided in this section, the term
7 “qualified small business stock” means any stock in a C corporation
8 which is originally issued after August 10, 1993, if both of the
9 following apply:

10 (A) As of the date of issuance, the corporation is a qualified
11 small business.

12 (B) Except as provided in subdivisions (f) and (h), the stock is
13 acquired by the taxpayer at its original issue (directly or through
14 an underwriter) in either of the following manners:

15 (i) In exchange for money or other property (not including
16 stock).

17 (ii) As compensation for services provided to the corporation
18 (other than services performed as an underwriter of the stock).

19 (2) (A) Stock in a corporation shall not be treated as qualified
20 small business stock unless, during substantially all of the
21 taxpayer’s holding period for the stock, the corporation meets the
22 active business requirements of subdivision (e) and the corporation
23 is a C corporation.

24 (B) (i) Notwithstanding subdivision (e), a corporation shall be
25 treated as meeting the active business requirements of subdivision
26 (e) for any period during which the corporation qualifies as a
27 specialized small business investment company.

28 (ii) For purposes of clause (i), the term “specialized small
29 business investment company” means any eligible corporation (as
30 defined in paragraph (4) of subdivision (e)) that is licensed to
31 operate under Section 301(d) of the Small Business Investment
32 Act of 1958 (as in effect on May 13, 1993).

33 (3) (A) Stock acquired by the taxpayer shall not be treated as
34 qualified small business stock if, at any time during the four-year
35 period beginning on the date two years before the issuance of the
36 stock, the corporation issuing the stock purchased (directly or
37 indirectly) any of its stock from the taxpayer or from a related
38 person (within the meaning of Section 267(b) or 707(b)) to the
39 taxpayer.

1 (B) Stock issued by a corporation shall not be treated as qualified
2 small business stock if, during the two-year period beginning on
3 the date one year before the issuance of the stock, the corporation
4 made one or more purchases of its stock with an aggregate value
5 (as of the time of the respective purchases) exceeding 5 percent
6 of the aggregate value of all of its stock as of the beginning of the
7 two-year period.

8 (C) If any transaction is treated under Section 304(a) of the
9 Internal Revenue Code as a distribution in redemption of the stock
10 of any corporation, for purposes of subparagraphs (A) and (B), the
11 corporation shall be treated as purchasing an amount of its stock
12 equal to the amount treated as a distribution in redemption of the
13 stock of the corporation under Section 304(a) of the Internal
14 Revenue Code.

15 (d) For purposes of this section:

16 (1) The term “qualified small business” means any domestic
17 corporation (as defined in Section 7701(a)(4) of the Internal
18 Revenue Code) which is a C corporation if all of the following
19 apply:

20 (A) The aggregate gross assets of the corporation (or any
21 predecessor thereof) at all times on or after July 1, 1993, and before
22 the issuance did not exceed fifty million dollars (\$50,000,000).

23 (B) The aggregate gross assets of the corporation immediately
24 after the issuance (determined by taking into account amounts
25 received in the issuance) do not exceed fifty million dollars
26 (\$50,000,000).

27 (C) At least 80 percent of the corporation’s payroll, as measured
28 by total dollar value, is attributable to employment located within
29 California.

30 (D) The corporation agrees to submit those reports to the
31 Franchise Tax Board and to shareholders as the Franchise Tax
32 Board may require to carry out the purposes of this section.

33 (2) (A) For purposes of paragraph (1), the term “aggregate
34 gross assets” means the amount of cash and the aggregate adjusted
35 basis of other property held by the corporation.

36 (B) For purposes of subparagraph (A), the adjusted basis of any
37 property contributed to the corporation (or other property with a
38 basis determined in whole or in part by reference to the adjusted
39 basis of property so contributed) shall be determined as if the basis
40 of the property contributed to the corporation immediately after

1 the contribution was equal to its fair market value as of the time
2 of the contribution.

3 (3) (A) All corporations which are members of the same
4 parent-subsidiary controlled group shall be treated as one
5 corporation for purposes of this subdivision.

6 (B) For purposes of subparagraph (A), the term
7 “parent-subsidiary controlled group” means any controlled group
8 of corporations as defined in Section 1563(a)(1) of the Internal
9 Revenue Code, except that both of the following shall apply:

10 (i) “More than 50 percent” shall be substituted for “at least 80
11 percent” each place it appears in Section 1563(a)(1) of the Internal
12 Revenue Code.

13 (ii) Section 1563(a)(4) of the Internal Revenue Code shall not
14 apply.

15 (e) (1) For purposes of paragraph (2) of subdivision (c), the
16 requirements of this subdivision are met by a corporation for any
17 period if during that period both of the following apply:

18 (A) At least 80 percent (by value) of the assets of the corporation
19 are used by the corporation in the active conduct of one or more
20 qualified trades or businesses in California.

21 (B) The corporation is an eligible corporation.

22 (2) For purposes of paragraph (1), if, in connection with any
23 future qualified trade or business, a corporation is engaged in:

24 (A) Startup activities described in Section 195(c)(1)(A) of the
25 Internal Revenue Code,

26 (B) Activities resulting in the payment or incurring of
27 expenditures which may be treated as research and experimental
28 expenditures under Section 174 of the Internal Revenue Code, or

29 (C) Activities with respect to in-house research expenses
30 described in Section 41(b)(4) of the Internal Revenue Code, then
31 assets used in those activities shall be treated as used in the active
32 conduct of a qualified trade or business. Any determination under
33 this paragraph shall be made without regard to whether a
34 corporation has any gross income from those activities at the time
35 of the determination.

36 (3) For purposes of this subdivision, the term “qualified trade
37 or business” means any trade or business other than any of the
38 following:

39 (A) Any trade or business involving the performance of services
40 in the fields of health, law, engineering, architecture, accounting,

1 actuarial science, performing arts, consulting, athletics, financial
2 services, brokerage services, or any trade or business where the
3 principal asset of the trade or business is the reputation or skill of
4 one or more of its employees.

5 (B) Any banking, insurance, financing, leasing, investing, or
6 similar business.

7 (C) Any farming business (including the business of raising or
8 harvesting trees).

9 (D) Any business involving the production or extraction of
10 products of a character with respect to which a deduction is
11 allowable under Section 613 or 613A of the Internal Revenue
12 Code.

13 (E) Any business of operating a hotel, motel, restaurant, or
14 similar business.

15 (4) For purposes of this subdivision, the term “eligible
16 corporation” means any domestic corporation, except that the term
17 shall not include any of the following:

18 (A) A DISC or former DISC.

19 (B) A corporation with respect to which an election under
20 Section 936 of the Internal Revenue Code is in effect or which has
21 a direct or indirect subsidiary with respect to which the election
22 is in effect.

23 (C) A regulated investment company, real estate investment
24 trust (REIT), or real estate mortgage investment conduit (REMIC).

25 (D) A cooperative.

26 (5) (A) For purposes of this subdivision, stock and debt in any
27 subsidiary corporation shall be disregarded and the parent
28 corporation shall be deemed to own its ratable share of the
29 subsidiary’s assets, and to conduct its ratable share of the
30 subsidiary’s activities.

31 (B) A corporation shall be treated as failing to meet the
32 requirements of paragraph (1) for any period during which more
33 than 10 percent of the value of its assets (in excess of liabilities)
34 consists of stock or securities in other corporations which are not
35 subsidiaries of the corporation (other than assets described in
36 paragraph (6)).

37 (C) For purposes of this paragraph, a corporation shall be
38 considered a subsidiary if the parent owns more than 50 percent
39 of the combined voting power of all classes of stock entitled to

1 vote, or more than 50 percent in value of all outstanding stock, of
2 the corporation.

3 (6) For purposes of subparagraph (A) of paragraph (1), the
4 following assets shall be treated as used in the active conduct of
5 a qualified trade or business:

6 (A) Assets that are held as a part of the reasonably required
7 working capital needs of a qualified trade or business of the
8 corporation.

9 (B) Assets that are held for investment and are reasonably
10 expected to be used within two years to finance research and
11 experimentation in a qualified trade or business or increases in
12 working capital needs of a qualified trade or business. For periods
13 after the corporation has been in existence for at least two years,
14 in no event may more than 50 percent of the assets of the
15 corporation qualify as used in the active conduct of a qualified
16 trade or business by reason of this paragraph.

17 (7) A corporation shall not be treated as meeting the
18 requirements of paragraph (1) for any period during which more
19 than 10 percent of the total value of its assets consists of real
20 property that is not used in the active conduct of a qualified trade
21 or business. For purposes of the preceding sentence, the ownership
22 of, dealing in, or renting of, real property shall not be treated as
23 the active conduct of a qualified trade or business.

24 (8) For purposes of paragraph (1), rights to computer software
25 that produces active business computer software royalties (within
26 the meaning of Section 543(d)(1) of the Internal Revenue Code)
27 shall be treated as an asset used in the active conduct of a trade or
28 business.

29 (9) A corporation shall not be treated as meeting the
30 requirements of paragraph (1) for any period during which more
31 than 20 percent of the corporation's total payroll expense is
32 attributable to employment located outside of California.

33 (f) If any stock in a corporation is acquired solely through the
34 conversion of other stock in the corporation that is qualified small
35 business stock in the hands of the taxpayer, both of the following
36 shall apply:

37 (1) The stock so acquired shall be treated as qualified small
38 business stock in the hands of the taxpayer.

39 (2) The stock so acquired shall be treated as having been held
40 during the period during which the converted stock was held.

1 (g) (1) If any amount included in gross income by reason of
2 holding an interest in a pass-through entity meets the requirements
3 of paragraph (2), then both of the following shall apply:

4 (A) The amount shall be treated as gain described in subdivision
5 (a).

6 (B) For purposes of applying subdivision (b), the amount shall
7 be treated as gain from a disposition of stock in the corporation
8 issuing the stock disposed of by the pass-through entity and the
9 taxpayer's proportionate share of the adjusted basis of the
10 pass-through entity in the stock shall be taken into account.

11 (2) An amount meets the requirements of this paragraph if both
12 of the following apply:

13 (A) The amount is attributable to gain on the sale or exchange
14 by the pass-through entity of stock that is qualified small business
15 stock in the hands of the entity (determined by treating the entity
16 as an individual) and that was held by that entity for more than
17 five years.

18 (B) The amount is includable in the gross income of the taxpayer
19 by reason of the holding of an interest in the entity that was held
20 by the taxpayer on the date on which the pass-through entity
21 acquired the stock and at all times thereafter before the disposition
22 of the stock by the pass-through entity.

23 (3) Paragraph (1) shall not apply to any amount to the extent
24 the amount exceeds the amount to which paragraph (1) would have
25 applied if the amount was determined by reference to the interest
26 the taxpayer held in the pass-through entity on the date the qualified
27 small business stock was acquired.

28 (4) For purposes of this subdivision, the term "pass-through
29 entity" means any of the following:

30 (A) Any partnership.

31 (B) Any S corporation.

32 (C) Any regulated investment company.

33 (D) Any common trust fund.

34 (h) For purposes of this section:

35 (1) In the case of a transfer described in paragraph (2), the
36 transferee shall be treated as meeting both of the following:

37 (A) Having acquired the stock in the same manner as the
38 transferor.

1 (B) Having held the stock during any continuous period
2 immediately preceding the transfer during which it was held (or
3 treated as held under this subdivision) by the transferor.

4 (2) A transfer is described in this subdivision if the transfer is
5 any of the following:

6 (A) By gift.

7 (B) At death.

8 (C) From a partnership to a partner of stock with respect to
9 which requirements similar to the requirements of subdivision (g)
10 are met at the time of the transfer (without regard to the five-year
11 holding period requirement).

12 (3) Rules similar to the rules of Section 1244(d)(2) of the
13 Internal Revenue Code shall apply for purposes of this section.

14 (4) (A) In the case of a transaction described in Section 351 of
15 the Internal Revenue Code or a reorganization described in Section
16 368 of the Internal Revenue Code, if qualified small business stock
17 is exchanged for other stock that would not qualify as qualified
18 small business stock but for this subparagraph, the other stock
19 shall be treated as qualified small business stock acquired on the
20 date on which the exchanged stock was acquired.

21 (B) This section shall apply to gain from the sale or exchange
22 of stock treated as qualified small business stock by reason of
23 subparagraph (A) only to the extent of the gain that would have
24 been recognized at the time of the transfer described in
25 subparagraph (A) if Section 351 or 368 of the Internal Revenue
26 Code had not applied at that time. The preceding sentence shall
27 not apply if the stock that is treated as qualified small business
28 stock by reason of subparagraph (A) is issued by a corporation
29 that (as of the time of the transfer described in subparagraph (A))
30 is a qualified small business.

31 (C) For purposes of this paragraph, stock treated as qualified
32 small business stock under subparagraph (A) shall be so treated
33 for subsequent transactions or reorganizations, except that the
34 limitation of subparagraph (B) shall be applied as of the time of
35 the first transfer to which the limitation applied (determined after
36 the application of the second sentence of subparagraph (B)).

37 (D) In the case of a transaction described in Section 351 of the
38 Internal Revenue Code, this paragraph shall apply only if
39 immediately after the transaction the corporation issuing the stock
40 owns directly or indirectly stock representing control (within the

1 meaning of Section 368(c) of the Internal Revenue Code) of the
2 corporation whose stock was exchanged.

3 (i) For purposes of this section:

4 (1) In the case where the taxpayer transfers property (other than
5 money or stock) to a corporation in exchange for stock in the
6 corporation, both of the following shall apply:

7 (A) The stock shall be treated as having been acquired by the
8 taxpayer on the date of the exchange.

9 (B) The basis of the stock in the hands of the taxpayer shall in
10 no event be less than the fair market value of the property
11 exchanged.

12 (2) If the adjusted basis of any qualified small business stock
13 is adjusted by reason of any contribution to capital after the date
14 on which the stock was originally issued, in determining the
15 amount of the adjustment by reason of the contribution, the basis
16 of the contributed property shall in no event be treated as less than
17 its fair market value on the date of the contribution.

18 (j) (1) If the taxpayer has an offsetting short position with
19 respect to any qualified small business stock, subdivision (a) shall
20 not apply to any gain from the sale or exchange of the stock unless
21 both of the following apply:

22 (A) The stock was held by the taxpayer for more than five years
23 as of the first day on which there was such a short position.

24 (B) The taxpayer elects to recognize gain as if the stock was
25 sold on that first day for its fair market value.

26 (2) For purposes of paragraph (1), the taxpayer shall be treated
27 as having an offsetting short position with respect to any qualified
28 small business stock if any of the following apply:

29 (A) The taxpayer has made a short sale of substantially identical
30 property.

31 (B) The taxpayer has acquired an option to sell substantially
32 identical property at a fixed price.

33 (C) To the extent provided in regulations, the taxpayer has
34 entered into any other transaction that substantially reduces the
35 risk of loss from holding the qualified small business stock. For
36 purposes of the preceding sentence, any reference to the taxpayer
37 shall be treated as including a reference to any person who is
38 related (within the meaning of Section 267(b) or 707(b) of the
39 Internal Revenue Code) to the taxpayer.

1 (k) The Franchise Tax Board may prescribe those regulations
2 as may be appropriate to carry out the purposes of this section,
3 including regulations to prevent the avoidance of the purposes of
4 this section through splitups, shell corporations, partnerships, or
5 otherwise.

6 (l) It is the intent of the Legislature that, in construing this
7 section, any regulations that may be promulgated by the Secretary
8 of the Treasury under Section 1202(k) of the Internal Revenue
9 Code shall apply to the extent that those regulations do not conflict
10 with this section or with any regulations that may be promulgated
11 by the Franchise Tax Board.

12 SEC. 3. This act provides for a tax levy within the meaning of
13 Article IV of the Constitution and shall go into immediate effect.

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