

AMENDED IN SENATE MAY 24, 2013

AMENDED IN SENATE APRIL 3, 2013

**SENATE BILL**

**No. 209**

---

**Introduced by Senator Lieu**

(Principal coauthors: Assembly Members Gorell and Perea)

February 11, 2013

---

An act to amend Section 18038.5 of, ~~and to amend, repeal, and add~~ *amend and repeal* Section 18152.5 of, *and to add Section 18153 to*, the Revenue and Taxation Code, relating to ~~taxation~~ *taxation, and making an appropriation therefor*.

LEGISLATIVE COUNSEL'S DIGEST

SB 209, as amended, Lieu. Income taxes: exclusion: deferral: qualified small business stock.

The Personal Income Tax Law, in modified conformity with federal law, provides various exclusions from gross income in computing tax liability.

This bill would, in reference to specified federal income tax laws, provide that gross income does not include ~~50%~~ 38% of any gain from the sale or exchange of qualified small business stock, as defined, held for more than 5 years, for taxable years beginning on or after January 1, 2008, and before January 1, 2013, as provided. ~~The bill would additionally, for taxable years beginning on or after January 1, 2016, exclude, and provide for a deferral of, gross income related to the gain from the sale or exchange of qualified small business stock, as provided.~~ *The bill would make a continuous appropriation from the General Fund to the Franchise Tax Board in those amounts necessary to make payments required by this bill.*

*The bill would require the Franchise Tax Board to waive all penalties and interest for taxes assessed and authorize a taxpayer to enter into a written installment payment agreement with the Franchise Tax Board for the payment of any taxes due, as a result of the decision of Cutler v. Franchise Tax Board, as specified. The bill would also require the Franchise Tax Board to waive all penalties and interest for taxes assessed and authorize a taxpayer to enter into a written installment payment agreement with the Franchise Tax Board for the payment of any taxes due, if specified provisions of the bill are held invalid, ineffective, or unconstitutional by a court of competent jurisdiction.*

*The bill would make a legislative finding and declaration regarding the public purpose served by the bill. The bill would state that its provisions are severable.*

Vote: ~~majority~~<sup>2/3</sup>. Appropriation: ~~no~~<sup>yes</sup>. Fiscal committee: yes. State-mandated local program: no.

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

- 1 SECTION 1. Section 18038.5 of the Revenue and Taxation  
 2 Code is amended to read:  
 3 18038.5. (a) In the case of any sale of qualified small business  
 4 stock held by a taxpayer other than a corporation for more than  
 5 six months and with respect to which that taxpayer elects the  
 6 application of this section, gain from that sale shall be recognized  
 7 only to the extent that the amount realized on that sale exceeds:  
 8 (1) The cost of any qualified small business stock purchased by  
 9 the taxpayer during the 60-day period beginning on the date of  
 10 that sale, reduced by  
 11 (2) Any portion of the cost previously taken into account under  
 12 this section.  
 13 This section shall not apply to any gain that is treated as ordinary  
 14 income for purposes of this part.  
 15 (b) For purposes of this section:  
 16 (1) The term “qualified small business stock” has the meaning  
 17 given that term by subdivision (c) of Section 18152.5.  
 18 (2) A taxpayer shall be treated as having purchased any property  
 19 if, but for paragraph (3), the unadjusted basis of that property in  
 20 the hands of the taxpayer would be its cost (within the meaning  
 21 of Section 1012 of the Internal Revenue Code).

1 (3) If gain from any sale is not recognized by reason of  
2 subdivision (a), that gain shall be applied to reduce (in the order  
3 acquired) the basis for determining gain or loss of any qualified  
4 small business stock that is purchased by the taxpayer during the  
5 60-day period described in subdivision (a).

6 (4) For purposes of determining whether the nonrecognition of  
7 gain under subdivision (a) applies to stock that is sold, both of the  
8 following shall apply:

9 (A) The taxpayer's holding period for that stock and the stock  
10 referred to in paragraph (1) of subdivision (a) shall be determined  
11 without regard to Section 1223 of the Internal Revenue Code.

12 (B) Only the first six months of the taxpayer's holding period  
13 for the stock referred to in paragraph (1) of subdivision (a) shall  
14 be taken into account for purposes of applying paragraph (2) of  
15 subdivision (c) of Section 18152.5.

16 (5) Rules similar to the rules of subdivisions (f), (g), (h), (i), (j),  
17 and (k) of Section 18152.5 shall apply.

18 (c) This section shall apply to sales made after August 5, 1997,  
19 and before January 1, ~~2013~~, and to sales made on and after January  
20 ~~1, 2016~~ 2013.

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

23 18152.5. (a) For purposes of this part, gross income shall not  
24 include ~~50~~ 38 percent of any gain from the sale or exchange of  
25 qualified small business stock held for more than five years.

26 (b) (1) If the taxpayer has eligible gain for the taxable year  
27 from one or more dispositions of stock issued by any corporation,  
28 the aggregate amount of the gain from dispositions of stock issued  
29 by the corporation which may be taken into account under  
30 subdivision (a) for the taxable year shall not exceed the greater of  
31 either of the following:

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

36 (B) Ten times the aggregate adjusted bases of qualified small  
37 business stock issued by the corporation and disposed of by the  
38 taxpayer during the taxable year. For purposes of ~~subparagraph~~  
39 ~~(B)~~ *this subparagraph*, the adjusted basis of any stock shall be

1 determined without regard to any addition to basis after the date  
2 on which the stock was originally issued.

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

6 (3) (A) In the case of a married individual filing a separate  
7 return, subparagraph (A) of paragraph (1) shall be applied by  
8 substituting five million dollars (\$5,000,000) for ten million dollars  
9 (\$10,000,000).

10 (B) In the case of a married taxpayer filing a joint return, the  
11 amount of gain taken into account under subdivision (a) shall be  
12 allocated equally between the spouses for purposes of applying  
13 this subdivision to subsequent taxable years.

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

16 (c) For purposes of this section:

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

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

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

26 (i) In exchange for money or other property (not including  
27 stock).

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

30 (2) (A) Stock in a corporation shall not be treated as qualified  
31 small business stock unless, during substantially all of the  
32 taxpayer’s holding period for the stock, the corporation meets the  
33 active business requirements of subdivision (e) and the corporation  
34 is a “C” corporation.

35 (B) (i) Notwithstanding subdivision (e), a corporation shall be  
36 treated as meeting the active business requirements of subdivision  
37 (e) for any period during which the corporation qualifies as a  
38 specialized small business investment company.

39 (ii) For purposes of clause (i), the term “specialized small  
40 business investment company” means any eligible corporation (as

1 defined in paragraph (4) of subdivision (e)) that is licensed to  
2 operate under Section 301(d) of the Small Business Investment  
3 Act of 1958 (as in effect on May 13, 1993).

4 (3) (A) Stock acquired by the taxpayer shall not be treated as  
5 qualified small business stock if, at any time during the four-year  
6 period beginning on the date two years before the issuance of the  
7 stock, the corporation issuing the stock purchased (directly or  
8 indirectly) any of its stock from the taxpayer or from a related  
9 person (within the meaning of Section 267(b) or 707(b)) to the  
10 taxpayer.

11 (B) Stock issued by a corporation shall not be treated as qualified  
12 small business stock if, during the two-year period beginning on  
13 the date one year before the issuance of the stock, the corporation  
14 made one or more purchases of its stock with an aggregate value  
15 (as of the time of the respective purchases) exceeding 5 percent  
16 of the aggregate value of all of its stock as of the beginning of the  
17 two-year period.

18 (C) If any transaction is treated under Section 304(a) of the  
19 Internal Revenue Code as a distribution in redemption of the stock  
20 of any corporation, for purposes of subparagraphs (A) and (B), the  
21 corporation shall be treated as purchasing an amount of its stock  
22 equal to the amount treated as a distribution in redemption of the  
23 stock of the corporation under Section 304(a) of the Internal  
24 Revenue Code.

25 (d) For purposes of this section:

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

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

33 (B) The aggregate gross assets of the corporation immediately  
34 after the issuance (determined by taking into account amounts  
35 received in the issuance) do not exceed fifty million dollars  
36 (\$50,000,000).

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

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

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

7 (B) For purposes of subparagraph (A), the adjusted basis of any  
8 property contributed to the corporation (or other property with a  
9 basis determined in whole or in part by reference to the adjusted  
10 basis of property so contributed) shall be determined as if the basis  
11 of the property contributed to the corporation immediately after  
12 the contribution was equal to its fair market value as of the time  
13 of the contribution.

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

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

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

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

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

29 (A) At least 80 percent (by value) of the assets of the corporation  
30 are used by the corporation in the active conduct of one or more  
31 qualified trades or businesses.

32 (B) The corporation is an eligible corporation.

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

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

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

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

8 (3) For purposes of this subdivision, the term “qualified trade  
9 or business” means any trade or business other than any of the  
10 following:

11 (A) Any trade or business involving the performance of services  
12 in the fields of health, law, engineering, architecture, accounting,  
13 actuarial science, performing arts, consulting, athletics, financial  
14 services, brokerage services, or any trade or business where the  
15 principal asset of the trade or business is the reputation or skill of  
16 one or more of its employees.

17 (B) Any banking, insurance, financing, leasing, investing, or  
18 similar business.

19 (C) Any farming business (including the business of raising or  
20 harvesting trees).

21 (D) Any business involving the production or extraction of  
22 products of a character with respect to which a deduction is  
23 allowable under Section 613 or 613A of the Internal Revenue  
24 Code.

25 (E) Any business of operating a hotel, motel, restaurant, or  
26 similar business.

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

30 (A) A DISC or former DISC.

31 (B) A corporation with respect to which an election under  
32 Section 936 of the Internal Revenue Code is in effect or which has  
33 a direct or indirect subsidiary with respect to which the election  
34 is in effect.

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

37 (D) A cooperative.

38 (5) (A) For purposes of this subdivision, stock and debt in any  
39 subsidiary corporation shall be disregarded and the parent  
40 corporation shall be deemed to own its ratable share of the

1 subsidiary's assets, and to conduct its ratable share of the  
2 subsidiary's activities.

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

9 (C) For purposes of this paragraph, a corporation shall be  
10 considered a subsidiary if the parent owns more than 50 percent  
11 of the combined voting power of all classes of stock entitled to  
12 vote, or more than 50 percent in value of all outstanding stock, of  
13 the corporation.

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

17 (A) Assets that are held as a part of the reasonably required  
18 working capital needs of a qualified trade or business of the  
19 corporation.

20 (B) Assets that are held for investment and are reasonably  
21 expected to be used within two years to finance research and  
22 experimentation in a qualified trade or business or increases in  
23 working capital needs of a qualified trade or business. For periods  
24 after the corporation has been in existence for at least two years,  
25 in no event may more than 50 percent of the assets of the  
26 corporation qualify as used in the active conduct of a qualified  
27 trade or business by reason of this paragraph.

28 (7) A corporation shall not be treated as meeting the  
29 requirements of paragraph (1) for any period during which more  
30 than 10 percent of the total value of its assets consists of real  
31 property that is not used in the active conduct of a qualified trade  
32 or business. For purposes of the preceding sentence, the ownership  
33 of, dealing in, or renting of, real property shall not be treated as  
34 the active conduct of a qualified trade or business.

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

1 (f) If any stock in a corporation is acquired solely through the  
2 conversion of other stock in the corporation that is qualified small  
3 business stock in the hands of the taxpayer, both of the following  
4 shall apply:

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

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

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

13 (A) The amount shall be treated as gain described in subdivision  
14 (a).

15 (B) For purposes of applying subdivision (b), the amount shall  
16 be treated as gain from a disposition of stock in the corporation  
17 issuing the stock disposed of by the ~~pass-through~~ *pass-thru* entity  
18 and the taxpayer's proportionate share of the adjusted basis of the  
19 ~~pass-through~~ *pass-thru* entity in the stock shall be taken into  
20 account.

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

23 (A) The amount is attributable to gain on the sale or exchange  
24 by the ~~pass-through~~ *pass-thru* entity of stock that is qualified small  
25 business stock in the hands of the entity (determined by treating  
26 the entity as an individual) and that was held by that entity for  
27 more than five years.

28 (B) The amount is includable in the gross income of the taxpayer  
29 by reason of the holding of an interest in the entity that was held  
30 by the taxpayer on the date on which the ~~pass-through~~ *pass-thru*  
31 entity acquired the stock and at all times thereafter before the  
32 disposition of the stock by the ~~pass-through~~ *pass-thru* entity.

33 (3) Paragraph (1) shall not apply to any amount to the extent  
34 the amount exceeds the amount to which paragraph (1) would have  
35 applied if the amount was determined by reference to the interest  
36 the taxpayer held in the ~~pass-through~~ *pass-thru* entity on the date  
37 the qualified small business stock was acquired.

38 (4) For purposes of this subdivision, the term "~~pass-through~~  
39 *pass-thru* entity" means any of the following:

40 (A) Any partnership.

1 (B) Any “S” corporation.

2 (C) Any regulated investment company.

3 (D) Any common trust fund.

4 (h) For purposes of this section:

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

7 (A) Having acquired the stock in the same manner as the  
8 transferor.

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

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

14 (A) By gift.

15 (B) At death.

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

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

22 (4) (A) In the case of a transaction described in Section 351 of  
23 the Internal Revenue Code or a reorganization described in Section  
24 368 of the Internal Revenue Code, if qualified small business stock  
25 is exchanged for other stock that would not qualify as qualified  
26 small business stock but for this subparagraph, the other stock  
27 shall be treated as qualified small business stock acquired on the  
28 date on which the exchanged stock was acquired.

29 (B) This section shall apply to gain from the sale or exchange  
30 of stock treated as qualified small business stock by reason of  
31 subparagraph (A) only to the extent of the gain that would have  
32 been recognized at the time of the transfer described in  
33 subparagraph (A) if Section 351 or 368 of the Internal Revenue  
34 Code had not applied at that time. The preceding sentence shall  
35 not apply if the stock that is treated as qualified small business  
36 stock by reason of subparagraph (A) is issued by a corporation  
37 that (as of the time of the transfer described in subparagraph (A))  
38 is a qualified small business.

39 (C) For purposes of this paragraph, stock treated as qualified  
40 small business stock under subparagraph (A) shall be so treated

1 for subsequent transactions or reorganizations, except that the  
2 limitation of subparagraph (B) shall be applied as of the time of  
3 the first transfer to which the limitation applied (determined after  
4 the application of the second sentence of subparagraph (B)).

5 (D) In the case of a transaction described in Section 351 of the  
6 Internal Revenue Code, this paragraph shall apply only if  
7 immediately after the transaction the corporation issuing the stock  
8 owns directly or indirectly stock representing control (within the  
9 meaning of Section 368(c) of the Internal Revenue Code) of the  
10 corporation whose stock was exchanged.

11 (i) For purposes of this section:

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

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

17 (B) The basis of the stock in the hands of the taxpayer shall in  
18 no event be less than the fair market value of the property  
19 exchanged.

20 (2) If the adjusted basis of any qualified small business stock  
21 is adjusted by reason of any contribution to capital after the date  
22 on which the stock was originally issued, in determining the  
23 amount of the adjustment by reason of the contribution, the basis  
24 of the contributed property shall in no event be treated as less than  
25 its fair market value on the date of the contribution.

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

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

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

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

37 (A) The taxpayer has made a short sale of substantially identical  
38 property.

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

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

8 (k) The Franchise Tax Board may prescribe those regulations  
 9 as may be appropriate to carry out the purposes of this section,  
 10 including regulations to prevent the avoidance of the purposes of  
 11 this section through splitups, shell corporations, partnerships, or  
 12 otherwise.

13 (l) It is the intent of the Legislature that, in construing this  
 14 section, any regulations that may be promulgated by the Secretary  
 15 of the Treasury under Section 1202(k) of the Internal Revenue  
 16 Code shall apply to the extent that those regulations do not conflict  
 17 with this section or with any regulations that may be promulgated  
 18 by the Franchise Tax Board.

19 *(m) Notwithstanding Section 13340 of the Government Code,*  
 20 *and without regard to fiscal year, there is hereby continuously*  
 21 *appropriated from the General Fund to the Franchise Tax Board*  
 22 *those amounts necessary to make the payments required by the*  
 23 *act adding this subdivision.*

24 ~~(m)~~

25 (n) The amendments made to this section by the act adding this  
 26 subdivision shall apply to each taxable year beginning on or after  
 27 January 1, 2008, and before January 1, 2013.

28 ~~(n)~~

29 (o) This section shall remain in effect only until January 1, 2016,  
 30 and as of that date is repealed, unless a later enacted statute, that  
 31 is enacted before January 1, 2016, deletes or extends that date.

32 ~~SEC. 3. Section 18152.5 is added to the Revenue and Taxation~~  
 33 ~~Code, to read:~~

34 ~~18152.5. (a) For each taxable year beginning on or after~~  
 35 ~~January 1, 2016, for purposes of this part, gross income shall not~~  
 36 ~~include 50 percent of any gain from the sale or exchange of~~  
 37 ~~qualified small business stock held for more than five years.~~

38 ~~(b) (1) If the taxpayer has eligible gain for the taxable year~~  
 39 ~~from one or more dispositions of stock issued by any corporation,~~  
 40 ~~the aggregate amount of the gain from dispositions of stock issued~~

1 by the corporation that may be taken into account under subdivision  
2 (a) for the taxable year shall not exceed the greater of either of the  
3 following:

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

8 (B) Ten times the aggregate adjusted bases of qualified small  
9 business stock issued by the corporation and disposed of by the  
10 taxpayer during the taxable year. For purposes of subparagraph  
11 (B), the adjusted basis of any stock shall be determined without  
12 regard to any addition to the basis after the date on which the stock  
13 was originally issued.

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

17 (3) (A) In the case of a married individual filing a separate  
18 return, subparagraph (A) of paragraph (1) shall be applied by  
19 substituting five million dollars (\$5,000,000) for ten million dollars  
20 (\$10,000,000).

21 (B) In the case of a married taxpayer filing a joint return, the  
22 amount of gain taken into account under subdivision (a) shall be  
23 allocated equally between the spouses for purposes of applying  
24 this subdivision to subsequent taxable years.

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

27 (e) For purposes of this section:

28 (1) Except as otherwise provided in this section, the term  
29 “qualified small business stock” means any stock in a “C”  
30 corporation that is originally issued after August 10, 1993, and  
31 before January 1, 2013, or issued after January 1, 2016, if both of  
32 the following apply:

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

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

38 (i) In exchange for money or other property (not including  
39 stock).

1 ~~(ii) As compensation for services provided to the corporation~~  
2 ~~(other than services performed as an underwriter of the stock):~~

3 ~~(2) (A) Stock in a corporation shall not be treated as qualified~~  
4 ~~small business stock unless, during substantially all of the~~  
5 ~~taxpayer's holding period for the stock, the corporation meets the~~  
6 ~~active business requirements of subdivision (e) and the corporation~~  
7 ~~is a "C" corporation:~~

8 ~~(B) (i) Notwithstanding subdivision (e), a corporation shall be~~  
9 ~~treated as meeting the active business requirements of subdivision~~  
10 ~~(e) for any period during which the corporation qualifies as a~~  
11 ~~specialized small business investment company:~~

12 ~~(ii) For purposes of clause (i), the term "specialized small~~  
13 ~~business investment company" means any eligible corporation (as~~  
14 ~~defined in paragraph (4) of subdivision (e)) that is licensed to~~  
15 ~~operate under Section 301(d) of the Small Business Investment~~  
16 ~~Act of 1958 (as in effect on May 13, 1993):~~

17 ~~(3) (A) Stock acquired by the taxpayer shall not be treated as~~  
18 ~~qualified small business stock if, at any time during the four-year~~  
19 ~~period beginning on the date two years before the issuance of the~~  
20 ~~stock, the corporation issuing the stock purchased (directly or~~  
21 ~~indirectly) any of its stock from the taxpayer or from a related~~  
22 ~~person (within the meaning of Section 267(b) or 707(b) of the~~  
23 ~~Internal Revenue Code) to the taxpayer:~~

24 ~~(B) Stock issued by a corporation shall not be treated as qualified~~  
25 ~~small business stock if, during the two-year period beginning on~~  
26 ~~the date one year before the issuance of the stock, the corporation~~  
27 ~~made one or more purchases of its stock with an aggregate value~~  
28 ~~(as of the time of the respective purchases) exceeding 5 percent~~  
29 ~~of the aggregate value of all of its stock as of the beginning of the~~  
30 ~~two-year period:~~

31 ~~(C) If any transaction is treated under Section 304(a) of the~~  
32 ~~Internal Revenue Code as a distribution in redemption of the stock~~  
33 ~~of any corporation, for purposes of subparagraphs (A) and (B), the~~  
34 ~~corporation shall be treated as purchasing an amount of its stock~~  
35 ~~equal to the amount treated as a distribution in redemption of the~~  
36 ~~stock of the corporation under Section 304(a) of the Internal~~  
37 ~~Revenue Code:~~

38 ~~(d) For purposes of this section:~~

39 ~~(1) The term "qualified small business" means any domestic~~  
40 ~~corporation (as defined in Section 7701(a)(4) of the Internal~~

1 Revenue Code) that is a “C” corporation if all of the following  
2 apply:

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

6 (B) ~~The aggregate gross assets of the corporation immediately~~  
7 ~~after the issuance (determined by taking into account amounts~~  
8 ~~received in the issuance) do not exceed fifty million dollars~~  
9 ~~(\$50,000,000).~~

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

13 (D) ~~The corporation agrees to submit those reports to the~~  
14 ~~Franchise Tax Board and to shareholders as the Franchise Tax~~  
15 ~~Board may require to carry out the purposes of this section.~~

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

19 (B) ~~For purposes of subparagraph (A), the adjusted basis of any~~  
20 ~~property contributed to the corporation (or other property with a~~  
21 ~~basis determined in whole or in part by reference to the adjusted~~  
22 ~~basis of property so contributed) shall be determined as if the basis~~  
23 ~~of the property contributed to the corporation immediately after~~  
24 ~~the contribution was equal to its fair market value as of the time~~  
25 ~~of the contribution.~~

26 (3) (A) ~~All corporations that are members of the same~~  
27 ~~parent-subsidiary controlled group shall be treated as one~~  
28 ~~corporation for purposes of this subdivision.~~

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

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

36 (ii) ~~Section 1563(a)(4) of the Internal Revenue Code shall not~~  
37 ~~apply.~~

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

1     ~~(A) At least 80 percent (by value) of the assets of the corporation~~  
2     ~~are used by the corporation in the active conduct of one or more~~  
3     ~~qualified trades or businesses.~~

4     ~~(B) The corporation is an eligible corporation.~~

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

7     ~~(A) Startup activities described in Section 195(c)(1)(A) of the~~  
8     ~~Internal Revenue Code;~~

9     ~~(B) Activities resulting in the payment or incurring of~~  
10    ~~expenditures that may be treated as research and experimental~~  
11    ~~expenditures under Section 174 of the Internal Revenue Code, or~~

12    ~~(C) Activities with respect to in-house research expenses~~  
13    ~~described in Section 41(b)(4) of the Internal Revenue Code, then~~  
14    ~~assets used in those activities shall be treated as used in the active~~  
15    ~~conduct of a qualified trade or business. Any determination under~~  
16    ~~this paragraph shall be made without regard to whether a~~  
17    ~~corporation has any gross income from those activities at the time~~  
18    ~~of the determination.~~

19    ~~(3) For purposes of this subdivision, the term “qualified trade~~  
20    ~~or business” means any trade or business other than any of the~~  
21    ~~following:~~

22    ~~(A) Any trade or business involving the performance of services~~  
23    ~~in the fields of health, law, engineering, architecture, accounting,~~  
24    ~~actuarial science, performing arts, consulting, athletics, financial~~  
25    ~~services, brokerage services, or any trade or business where the~~  
26    ~~principal asset of the trade or business is the reputation or skill of~~  
27    ~~one or more of its employees.~~

28    ~~(B) Any banking, insurance, financing, leasing, investing, or~~  
29    ~~similar business.~~

30    ~~(C) Any farming business (including the business of raising or~~  
31    ~~harvesting trees).~~

32    ~~(D) Any business involving the production or extraction of~~  
33    ~~products of a character with respect to which a deduction is~~  
34    ~~allowable under Section 613 or 613A of the Internal Revenue~~  
35    ~~Code.~~

36    ~~(E) Any business of operating a hotel, motel, restaurant, or~~  
37    ~~similar business.~~

38    ~~(4) For purposes of this subdivision, the term “eligible~~  
39    ~~corporation” means any domestic corporation, except that the term~~  
40    ~~shall not include any of the following:~~

1 ~~(A) A DISC or former DISC.~~

2 ~~(B) A corporation with respect to which an election under~~  
3 ~~Section 936 of the Internal Revenue Code is in effect or which has~~  
4 ~~a direct or indirect subsidiary with respect to which the election~~  
5 ~~is in effect.~~

6 ~~(C) A regulated investment company, real estate investment~~  
7 ~~trust (REIT), or real estate mortgage investment conduit (REMIC).~~

8 ~~(D) A cooperative.~~

9 ~~(5) (A) For purposes of this subdivision, stock and debt in any~~  
10 ~~subsidiary corporation shall be disregarded and the parent~~  
11 ~~corporation shall be deemed to own its ratable share of the~~  
12 ~~subsidiary's assets, and to conduct its ratable share of the~~  
13 ~~subsidiary's activities.~~

14 ~~(B) A corporation shall be treated as failing to meet the~~  
15 ~~requirements of paragraph (1) for any period during which more~~  
16 ~~than 10 percent of the value of its assets (in excess of liabilities)~~  
17 ~~consists of stock or securities in other corporations that are not~~  
18 ~~subsidiaries of the corporation (other than assets described in~~  
19 ~~paragraph (6)).~~

20 ~~(C) For purposes of this paragraph, a corporation shall be~~  
21 ~~considered a subsidiary if the parent owns more than 50 percent~~  
22 ~~of the combined voting power of all classes of stock entitled to~~  
23 ~~vote, or more than 50 percent in value of all outstanding stock, of~~  
24 ~~the corporation.~~

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

28 ~~(A) Assets that are held as a part of the reasonably required~~  
29 ~~working capital needs of a qualified trade or business of the~~  
30 ~~corporation.~~

31 ~~(B) Assets that are held for investment and are reasonably~~  
32 ~~expected to be used within two years to finance research and~~  
33 ~~experimentation in a qualified trade or business or increases in the~~  
34 ~~working capital needs of a qualified trade or business. For periods~~  
35 ~~after the corporation has been in existence for at least two years,~~  
36 ~~in no event may more than 50 percent of the assets of the~~  
37 ~~corporation qualify as used in the active conduct of a qualified~~  
38 ~~trade or business by reason of this paragraph.~~

39 ~~(7) A corporation shall not be treated as meeting the~~  
40 ~~requirements of paragraph (1) for any period during which more~~

1 than 10 percent of the total value of its assets consists of real  
2 property that is not used in the active conduct of a qualified trade  
3 or business. For purposes of the preceding sentence, the ownership  
4 of, dealing in, or renting of, real property shall not be treated as  
5 the active conduct of a qualified trade or business.

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

11 (f) If any stock in a corporation is acquired solely through the  
12 conversion of other stock in the corporation that is qualified small  
13 business stock in the hands of the taxpayer, both of the following  
14 shall apply:

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

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

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

22 (A) The amount shall be treated as gain described in subdivision  
23 (a).

24 (B) For purposes of applying subdivision (b), the amount shall  
25 be treated as gain from a disposition of stock in the corporation  
26 issuing the stock disposed of by the pass-thru entity and the  
27 taxpayer's proportionate share of the adjusted basis of the pass-thru  
28 entity in the stock shall be taken into account.

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

31 (A) The amount is attributable to gain on the sale or exchange  
32 by the pass-thru entity of stock that is qualified small business  
33 stock in the hands of the entity (determined by treating the entity  
34 as an individual) and that was held by that entity for more than  
35 five years.

36 (B) The amount is includable in the gross income of the taxpayer  
37 by reason of the holding of an interest in the entity that was held  
38 by the taxpayer on the date on which the pass-thru entity acquired  
39 the stock and at all times thereafter before the disposition of the  
40 stock by the pass-thru entity.

1 ~~(3) Paragraph (1) shall not apply to any amount to the extent~~  
2 ~~the amount exceeds the amount to which paragraph (1) would have~~  
3 ~~applied if the amount was determined by reference to the interest~~  
4 ~~the taxpayer held in the pass-thru entity on the date the qualified~~  
5 ~~small business stock was acquired.~~

6 ~~(4) For purposes of this subdivision, the term “pass-thru entity”~~  
7 ~~means any of the following:~~

8 ~~(A) Any partnership.~~

9 ~~(B) Any “S” corporation.~~

10 ~~(C) Any regulated investment company.~~

11 ~~(D) Any common trust fund.~~

12 ~~(h) For purposes of this section:~~

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

15 ~~(A) Having acquired the stock in the same manner as the~~  
16 ~~transferor.~~

17 ~~(B) Having held the stock during any continuous period~~  
18 ~~immediately preceding the transfer during which it was held (or~~  
19 ~~treated as held under this subdivision) by the transferor.~~

20 ~~(2) A transfer is described in this subdivision if the transfer is~~  
21 ~~any of the following:~~

22 ~~(A) By gift.~~

23 ~~(B) At death.~~

24 ~~(C) From a partnership to a partner of stock with respect to~~  
25 ~~which requirements similar to the requirements of subdivision (g)~~  
26 ~~are met at the time of the transfer (without regard to the five-year~~  
27 ~~holding period requirement).~~

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

30 ~~(4) (A) In the case of a transaction described in Section 351 of~~  
31 ~~the Internal Revenue Code or a reorganization described in Section~~  
32 ~~368 of the Internal Revenue Code, if qualified small business stock~~  
33 ~~is exchanged for other stock that would not qualify as qualified~~  
34 ~~small business stock but for this subparagraph, the other stock~~  
35 ~~shall be treated as qualified small business stock acquired on the~~  
36 ~~date on which the exchanged stock was acquired.~~

37 ~~(B) This section shall apply to gain from the sale or exchange~~  
38 ~~of stock treated as qualified small business stock by reason of~~  
39 ~~subparagraph (A) only to the extent of the gain that would have~~  
40 ~~been recognized at the time of the transfer described in~~

1 subparagraph (A) if Section 351 or 368 of the Internal Revenue  
2 Code had not applied at that time. The preceding sentence shall  
3 not apply if the stock that is treated as qualified small business  
4 stock by reason of subparagraph (A) is issued by a corporation  
5 that (as of the time of the transfer described in subparagraph (A))  
6 is a qualified small business.

7 (C) For purposes of this paragraph, stock treated as qualified  
8 small business stock under subparagraph (A) shall be so treated  
9 for subsequent transactions or reorganizations, except that the  
10 limitation of subparagraph (B) shall be applied as of the time of  
11 the first transfer to which the limitation applied (determined after  
12 the application of the second sentence of subparagraph (B)).

13 (D) In the case of a transaction described in Section 351 of the  
14 Internal Revenue Code, this paragraph shall apply only if  
15 immediately after the transaction the corporation issuing the stock  
16 owns directly or indirectly stock representing control (within the  
17 meaning of Section 368(e) of the Internal Revenue Code) of the  
18 corporation whose stock was exchanged.

19 (i) For purposes of this section:

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

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

25 (B) The basis of the stock in the hands of the taxpayer shall not  
26 be less than the fair market value of the property exchanged.

27 (2) If the adjusted basis of any qualified small business stock  
28 is adjusted by reason of any contribution to capital after the date  
29 on which the stock was originally issued, in determining the  
30 amount of the adjustment by reason of the contribution, the basis  
31 of the contributed property shall not be treated as less than its fair  
32 market value on the date of the contribution.

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

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

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

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

4     ~~(A) The taxpayer has made a short sale of substantially identical~~  
5 ~~property.~~

6     ~~(B) The taxpayer has acquired an option to sell substantially~~  
7 ~~identical property at a fixed price.~~

8     ~~(C) To the extent provided in regulations, the taxpayer has~~  
9 ~~entered into any other transaction that substantially reduces the~~  
10 ~~risk of loss from holding the qualified small business stock. For~~  
11 ~~purposes of the preceding sentence, any reference to the taxpayer~~  
12 ~~shall be treated as including a reference to any person who is~~  
13 ~~related (within the meaning of Section 267(b) or 707(b) of the~~  
14 ~~Internal Revenue Code) to the taxpayer.~~

15     ~~(k) The Franchise Tax Board may prescribe those regulations~~  
16 ~~as may be appropriate to carry out the purposes of this section,~~  
17 ~~including regulations to prevent the avoidance of the purposes of~~  
18 ~~this section through splitups, shell corporations, partnerships, or~~  
19 ~~otherwise.~~

20     ~~(l) It is the intent of the Legislature that, in construing this~~  
21 ~~section, any regulations that may be promulgated by the Secretary~~  
22 ~~of the Treasury under Section 1202(k) of the Internal Revenue~~  
23 ~~Code shall apply to the extent that those regulations do not conflict~~  
24 ~~with this section or with any regulations that may be promulgated~~  
25 ~~by the Franchise Tax Board.~~

26     ~~(m) This section shall become operative on January 1, 2016.~~

27     ~~SEC. 3. Section 18153 is added to the Revenue and Taxation~~  
28 ~~Code, to read:~~

29     ~~18153. (a) (1) The Franchise Tax Board shall waive all~~  
30 ~~penalties and interest for taxes assessed as a result of the decision~~  
31 ~~of Cutler v. Franchise Tax Bd. (208 Cal.App.4th 1247) for each~~  
32 ~~taxable year beginning on or after January 1, 2008, and before~~  
33 ~~January 1, 2013.~~

34     ~~(2) A taxpayer may enter into a written installment payment~~  
35 ~~agreement with the Franchise Tax Board for the payment of any~~  
36 ~~taxes due as a result of the decision of Cutler v. Franchise Tax~~  
37 ~~Bd. (208 Cal.App.4th 1247) in installments for a period of up to~~  
38 ~~five years.~~

1 (b) If Section 18152.5 is for any reason held invalid, ineffective,  
2 or unconstitutional by a court of competent jurisdiction, both of  
3 the following shall apply:

4 (1) The Franchise Tax Board shall waive all penalties and  
5 interest imposed as a result of Section 18152.5 held invalid,  
6 ineffective, or unconstitutional, for each taxable year beginning  
7 on or after January 1, 2008, and before January 1, 2013.

8 (2) A taxpayer may enter into a written installment payment  
9 agreement with the Franchise Tax Board for the payment of any  
10 taxes due, as a result of Section 18152.5 held invalid, ineffective,  
11 or unconstitutional, in installments for a period of up to five years.

12 SEC. 4. The Legislature finds and declares that the retroactive  
13 application of the amendments made to Section 18152.5 and the  
14 addition of Section 18153 by this act serve a public purpose by  
15 providing equitable tax treatment and fair tax relief to taxpayers  
16 that are stimulating the economy of the state and does not  
17 constitute a gift of public funds within the meaning of Section 6 of  
18 Article XVI of the California Constitution.

19 SEC. 5. The provisions of this act are severable. If any  
20 provision of this act or its application is held invalid, that invalidity  
21 shall not affect other provisions or applications that can be given  
22 effect without the invalid provision or application.