

Senate Bill No. 209

CHAPTER 543

An act to amend and repeal Sections 18038.5 and 18152.5 of, and to add and repeal Section 18153 of, the Revenue and Taxation Code, relating to taxation.

[Approved by Governor October 4, 2013. Filed with
Secretary of State October 4, 2013.]

LEGISLATIVE COUNSEL'S DIGEST

SB 209, 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 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 The provisions would be repealed on January 1, 2016.

The bill, with regard to personal income tax, would provide that a penalty shall not be imposed with respect to the additional tax, as defined, of a taxpayer, and interest shall not accrue with respect to the additional tax of that taxpayer due for the taxable year. The bill would require the Franchise Tax Board, in the case of a liability for additional tax of a taxpayer, notwithstanding certain other eligibility requirements, to enter into an agreement to accept the full payment of the additional tax in installments over a period not to exceed 5 years. These provisions would be repealed on January 1, 2018.

The bill would authorize any claim for credit or refund pursuant to the bill to be filed within 180 days of its effective date, as provided.

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 not severable, except as provided.

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

SECTION 1. Section 18038.5 of the Revenue and Taxation Code is amended to read:

18038.5. (a) In the case of any sale of qualified small business stock held by a taxpayer other than a corporation for more than six months and with respect to which that taxpayer elects the application of this section,

gain from that sale shall be recognized only to the extent that the amount realized on that sale exceeds:

(1) The cost of any qualified small business stock purchased by the taxpayer during the 60-day period beginning on the date of that sale, reduced by

(2) Any portion of the cost previously taken into account under this section.

This section shall not apply to any gain that is treated as ordinary income for purposes of this part.

(b) For purposes of this section:

(1) The term “qualified small business stock” has the meaning given that term by subdivision (c) of Section 18152.5.

(2) A taxpayer shall be treated as having purchased any property if, but for paragraph (3), the unadjusted basis of that property in the hands of the taxpayer would be its cost (within the meaning of Section 1012 of the Internal Revenue Code).

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

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

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

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

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

(c) This section shall apply to sales made after August 5, 1997, and before January 1, 2013.

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

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

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

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

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

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

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

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

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

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

(c) For purposes of this section:

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

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

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

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

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

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

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

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

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

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

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

(d) For purposes of this section:

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

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

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

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

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

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

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

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

(B) For purposes of subparagraph (A), the term “parent-subsiary controlled group” means any controlled group of corporations as defined

in Section 1563(a)(1) of the Internal Revenue Code, except that both of the following shall apply:

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

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

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

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

(B) The corporation is an eligible corporation.

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

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

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

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

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

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

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

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

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

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

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

(A) A DISC or former DISC.

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

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

(D) A cooperative.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(A) Any partnership.

(B) Any "S" corporation.

(C) Any regulated investment company.

(D) Any common trust fund.

(h) For purposes of this section:

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

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

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

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

(A) By gift.

(B) At death.

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

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

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

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

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

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

(i) For purposes of this section:

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

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

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

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

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

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

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

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

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

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

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

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

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

(m) The amendments made to this section by the act adding this subdivision shall apply to sales, including installment sales, occurring in each taxable year beginning on or after January 1, 2008, and before January 1, 2013, and installment payments received in taxable years beginning on or after January 1, 2008, for sales of qualified small business stock made in taxable years beginning before January 1, 2013.

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

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

18153. (a) In the case of a taxpayer subject to tax under this part:

(1) A penalty shall not be imposed with respect to the additional tax of that taxpayer.

(2) Interest shall not accrue with respect to the additional tax of that taxpayer due for the taxable year.

(3) In the case of a liability for additional tax of a taxpayer under this part, notwithstanding any other eligibility requirements contained in Section 19008, the Franchise Tax Board shall enter into an agreement under Section 19008 to accept the full payment of the additional tax in installments over a period not to exceed five years.

(b) For purposes of subdivision (a), the term “additional tax” means:

(1) The increase in tax for a taxable year beginning on or after January 1, 2008, and before January 1, 2013, to the extent that the increase is attributable to the amendments made to Section 18152.5 by the act adding this section.

(2) If Section 18152.5, as amended by the act adding this section, is for any reason held invalid, ineffective, or unconstitutional by an appellate court of competent jurisdiction, the term “additional tax” means the increase in tax for a taxable year beginning on or after January 1, 2008, and before January 1, 2013, to the extent that the increase is attributable to the implementation of the appellate court holding invalidating Section 18152.5, as amended by the act adding this section, coupled with the implementation of the decision of the California Court of Appeal, *Frank Cutler v. Franchise Tax Board*, (2012) 208 Cal.App.4th 1247, as announced in Franchise Tax Board Notice 2012–03, dated December 21, 2012.

(c) This section shall remain in effect only until January 1, 2018, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2018, deletes or extends that date.

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

SEC. 5. Notwithstanding any other law, any claim for credit or refund for taxable years beginning on or after January 1, 2008, and ending before January 1, 2009, resulting from this act may be filed within 180 days of the effective date of this act.

SEC. 6. (a) Except as set forth in subdivision (b), the provisions of this act are not severable. If any provision of this act or its application is held invalid, that invalidity shall apply to the other provisions or applications of this act.

(b) The provisions of Section 18153 of the Revenue and Taxation Code as added by Section 3 of this act are severable from the remainder of this act. If any provision of the remainder of this act is held invalid, that invalidity shall not affect the provisions or applications of Section 18153 of the Revenue and Taxation Code as added by Section 3 of this act that can be given effect without the invalid provision or application.