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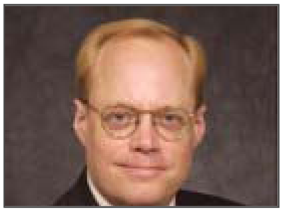

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About Face! California Passes Retroactive Small Business Stock Tax Break

CA Gov. Jerry Brown (Image credit: Getty Images via @daylife)

California's Gov. Jerry Brown is known for ***raising*** taxes not ***cutting*** them. He championed sweeping retroactive tax hikes in November 2012, sending rates for $1 million-plus-earners to 13.3%, up from 10.3%. And he's generally not viewed as a friend to business either.

Yet Brown signed into law a widely watched bill ***retroactively*** allowing Qualified Small Business Stock exclusions and deferrals for 2008 – 2012. Yes, that's a tax cut and one favoring business and investors with money. Broadly stated, Qualified Small Business Stock (QSBS) is issued by a C corporation with no more than $50 million of assets and at least 80% of its assets used in an active business (excluding personal services, finance, farming, restaurants, hotels, etc). See Tax-Free In 2011: Qualified Small Business Stock.

California's version of the tax break allowed the exclusion of 50% of capital gains earned from investments under $50 million. But California's version also required virtually ***everything*** to be in California. In *Frank Cutler v. Franchise Tax Board*, a California court held that was unconstitutional.

But that didn't stop California's notoriously obstreperous tax collectors who pushed assessments anyway saying that even those who did clearly qualify for the break would be taxed. In response to *Cutler*, California's FTB announced in [FTB Notice No. 2012-03] that the QSBS statute was invalid in its ***entirety***. Many were facing crippling tax liabilities.

Fortunately, AB 1412 breaks with California's fiercely fought tax rules. Now there is no requirement for the company to have 80% of its assets and payroll in California while the taxpayer held the stock. What's more, California taxpayers who have not yet filed their 2012 return can claim the QSBS exclusion or deferral. For taxpayers who filed their 2008 – 2012 tax returns and were contacted by California's Franchise Tax Board regarding their QSBS election, the FTB will notify them that:

- Pending Notices of Proposed Assessment based on the *Cutler* decision or FTB Notice 2012-3 will be withdrawn;
- Closing letters will be mailed to taxpayers who signed a limited QSBS waiver for 2008;
- Unpaid tax, interest, or penalties assessed as a result of the *Cutler* decision/FTB Notice 2012-3 will be abated; and
- Refunds for payments received related to the *Cutler* decision/FTB Notice 2012-3 will be issued. No action is needed by taxpayers to request refunds, unless they do not hear from the FTB by November 30, 2013. In these circumstances, taxpayers may contact the FTB at (916) 845-3030.

If a federal QSBS exclusion was claimed but the California QSBS exclusion was not, a taxpayer may want to file an amended California return to claim the exclusion. The California exclusion could be applicable if the company had 80% of its payroll in California when the taxpayer purchased the stock.

All refund claims must be filed prior to the expiration of the statute of limitations. In addition to the normal four-year statute of limitation, AB 1412 allows taxpayers until June 30, 2014, to file a QSBS claim for refund for tax year 2008. Amended returns should state in red "QSBS CLAIM FOR REFUND" at the top of the return, and be mailed to:

Cutler Claim for Refund 347 MS: F381
Franchise Tax Board
C/O FTB Notice 2012-03
P.O. Box 1779
Rancho Cordova, CA 95741-1779

For Courier Service Delivery or Private Courier Mail:

Franchise Tax Board
9646 Butterfield Way
Sacramento, CA 95827

For additional information, check the FTB's website for guidance, which should be posted in the near future.

Is this a big deal? It sure is. It was the only thing that seemed remotely fair. Still, as tough a tax environment as prevails in California, it wasn't a forgone conclusion. Who knows, perhaps Gov. Brown will imitate Rick Perry, visit Texas, and to try to lure Texans to California.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.