

California to start issuing assessment notices in April for invalid qualified small business stock gain exclusions and deferrals

March 7, 2013

In brief

The California Franchise Tax Board recently released updates to its Frequently Asked Questions (FAQ) page regarding treatment of previously allowed qualified small business stock (QSBS) gain exclusions and deferrals that were ruled invalid pursuant to the California Supreme Court's decision in *Cutler v. Franchise Tax Board*. The FAQ additions provide that the FTB intends to send Notices of Proposed Assessments in early April 2013 and will continue to issue them before the applicable statute(s) of limitations expire. California taxpayers who took QSBS gain exclusions or deferrals in tax years that remain open under statute should be prepared for assessments to be issued by the FTB. [[Qualified Small Business Stock \(QSBS\) Gains – FAQs](#)]

In detail

The Cutler decision

Similar to federal income tax provisions, California law allows individual taxpayers a 50% *exclusion* and/or a *deferral* on gains relating to qualified small business stock. However, unlike federal provisions, this California exclusion and/or deferral is limited to investments in small businesses predominately based in California.

In *Cutler v. Franchise Tax Board*, a California Appeals Court held that the California rules limiting the benefits to investments in **in-state**

businesses were unconstitutional. [Click here](#) for our summary of the *Cutler* decision.

FTB to deny previously allowed QSBS gain exclusions and deferrals starting in 2008

In December 2012, the FTB issued Notice 2012-03, which summarized how the FTB intends to implement the *Cutler* decision, including completely denying taxpayers the QSBS exclusion and deferral for 2008 and later tax years. For tax years prior to 2008, the FTB will allow the exclusion/deferral to taxpayers that meet all QSBS qualifications other than the

unconstitutional in-state requirements. [Click here](#) for our summary of FTB Notice 2012-03.

New FAQ guidance – assessments starting in April

Along with FTB Notice 2012-03, the FTB provided an [FAQ page](#) on its website with additional guidance for its implementation of *Cutler*. On February 28, 2013, the FTB added several items to its FAQ page, including:

- Notices of Proposed Assessment (NPA) “will be sent beginning in early April

2013 and will continue to be issued before the applicable statute(s) of limitations expire.”

- Taxpayers may request a waiver of the 2008 statute of limitations to postpone the issuance of an NPA.
- The FTB has established procedures for taxpayers to protest the QSBS tax assessments.
- When protesting a proposed QSBS tax assessment, a taxpayer may request the FTB to defer action on the protest pending 2013 legislative action that may impact

the QSBS proposed assessment. However, interest will continue to accrue unless a deposit is made to stop the running of interest.

The takeaway

While taxpayers can expect NPAs on disallowed exclusions/deferrals relating to a QSBS gain starting in April 2013, taxpayers do have some options – including a waiver of the 2008 statute of limitations (to the extent such waiver is valuable) and a request to defer actions on a protest pending legislative action, including [Assembly Bill 901](#), which was

introduced on February 22, 2013, and may be heard in committee on March 26, 2013.

Note that under California’s interest suspension rules, a taxpayer that files an amended 2008 return would not be allowed interest suspension. Interest suspension applies to the period between the expiration of 36 months from the date the original return was filed and the date that the FTB issues its NPA. Accordingly, it may be to some taxpayers’ advantage for FTB to make the adjustment by NPA rather than by the taxpayer filing an amended return.

Let’s talk

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