

Franchise Tax Board Update on Qualified Small Business Stock

The Franchise Tax Board (FTB) has released [guidance](#) on its position regarding the *Cutler v. Franchise Tax Bd.* decision and qualified small business stock (QSBS). As we discussed in a prior [Corporate Law Alert](#), the *Cutler* decision held that California Revenue & Tax Code Sections 18152.5 and 18038.5 are unconstitutional since they unfairly discriminates against investors in companies which conduct a portion of their business outside of California.

Since the *Cutler* decision was handed down, many California taxpayers have expressed concern regarding the treatment of their QSBS currently and prospectively. [FTB Notice 2012-03](#) now provides taxpayers with the FTB's position.

The notice indicates the FTB intends to deny the exclusion or deferral to any taxpayer who claimed the benefit of Sections 18152.5 and 18038.5 on or after January 1, 2008. According to the notice, the FTB will begin issuing notices of deficiency to taxpayers in every case where such exclusion or deferral was claimed.

The FTB notice is nothing less than radical, given that the taxpayer in *Cutler* won on the argument that the geographical restrictions on Sections 18152.5 and 18038.5 are unconstitutional. The FTB appears to have taken the position that the proper remedy to the *Cutler* decision is to treat the statutes as *effectively void*. Had the court taken that position, the taxpayer in *Cutler* would have been *denied* the benefits of the statutes—that is, the taxpayer would have lost.

The FTB's position is bound to affect countless taxpayers involved in high tech industry in the Bay Area, as well as many other taxpayers. The Taxpayers who have benefited from the California QSBS statutes since 2008 should consider seeking legal counsel and developing responses to the notices of deficiency that may already be on the way.

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