



STATE OF CALIFORNIA
FRANCHISE TAX BOARD
Legal Branch
PO Box 2229
Sacramento, CA 95812-2229
(916) 845-3307 Fax (916) 845-3191

KATHLEEN CONNELL
Chair

CLAUDE PARRISH
Member

B. TIMOTHY GAGE
Member

January 25, 2001

Re: *****

Dear *****:

***** , you requested a Chief Counsel Ruling regarding the interpretation of California Revenue and Taxation Code (RTC) section 18038.5. RTC section 18038.5 allows an **individual** to elect and defer gains on sales of QSBS if the proceeds from the sale are reinvested into another QSBS within 60 days. Your interpretation of the statute is that partnerships, as well as individuals, should be allowed to elect and defer the gains on sales of QSBS if RTC section 18038.5 criteria are met. Your interpretation would make RTC section 18038.5, as it is currently written, consistent to the current federal counterpart, Internal Revenue Code (IRC) section 1045(a).

While this letter is not a response to your ruling request, at this time we would suggest that an understanding of the federal enactment and amendment of IRC section 1045(a) is necessary to an understanding of the proper interpretation of the California statute. IRC section 1045(a) was enacted by the Taxpayer Relief Act of 1997 (Pub. L. No. 105-34, § 313(a) (Aug. 5, 1997) 111 Stat. 788), which only allowed **individuals** to elect and defer gains on sales of QSBS. Subsequently, IRC section 1045(a) was amended by the Internal Revenue Service Restructuring and Reform Act of 1998 (Pub. L. No. 105-206, § 6005(f) (July 22, 1998), 112 Stat.685), which changed the word **individuals** to **taxpayers**. This amendment allowed flow-through entities to elect and defer the gains on sales of QSBS, since flow-through entities are defined as taxpayers.

While California has conformed to the original version of IRC section 1045(a) as enacted by section 313(a) of the Taxpayer Relief Act of 1997, it has yet to conform to the amended version of section 6005(f) of the Internal Revenue Service Restructuring and Reform Act of 1998.

Currently, Assembly Bill (AB) No. 10 is pending before the California Legislature, which has in it a conformity provision for RTC section 18038.5 that would change

January 25, 2001
Page 2

the word **individuals** to **taxpayers**, thus allowing flow-through entities, including partnerships, to qualify for the deferral of gains on sales of QSBS. The bill appears to be on a fast track through the legislative process; it is possible that it will be enacted into law by March 15, 2001. Because the conformity provision for RTC section 18038.5 would be retroactive, if the bill passes by March 15, 2001, then sales made by a flow-through entity after August 5, 1997, may qualify for the deferral provisions. Therefore, we will delay responding to your request for a ruling until after March 2001.

I would, however, like to bring to your attention the fact that your ruling request did not include the partnership name and identification number, as required by FTB Notice 89-277 (a copy of which is attached for your convenience). Please provide that information at your earliest opportunity. If you have any questions, please feel free to telephone.

Very truly yours,

John S. Choi,
Program Specialist – Legal Branch

Enclosure: FTB Notice 89 277