

FTB NOTICE

California Franchise Tax Board - Legal Branch



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FTB NOTICE 96-2

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SUBJECT: FTB FORM 3565, SMALL BUSINESS STOCK QUESTIONNAIRE

The Franchise Tax Board ("FTB") has received several questions regarding a corporation's failure to timely file Form 3565, Small Business Stock Questionnaire, and the impact on a stockholder's ability to benefit from small business stock treatment when the stock is sold or exchanged. The purpose of this notice is to revise and supplement Form 3565.

Revenue and Taxation Code ("Rev. & Tax. Code") section 18152.5 permits individuals to exclude from income an amount equal to 50% of the gain from the sale or exchange of qualified small business stock. The stock must qualify as of the date of issuance and such qualification imposes an obligation on the issuing corporation to submit those reports required by the FTB. See Rev. & Tax. Code §§ 18152.5(c)(1)(A), 18152.5(d)(1)(D).

Form 3565 was issued as part of the 1995 California Package X. Form 3565 requires corporations that are qualified small businesses and issued stock during the period August 10, 1993 through the end of the 1995 income year to file a completed Form 3565 with the FTB on or before the due date of the corporate return, without regard to extensions. Form 3565 also states that the failure of a corporation to timely file the form may disqualify the stockholders from excluding 50% of the gain upon sale or exchange.

The following are revisions to Form 3565:

- 1) The due date of Form 3565 remains the original due date of the return, but no penalties will be imposed on the corporation (issuer) if Form 3565 is filed on or before the due date of the corporate return, including extensions. After that date, a penalty will be imposed pursuant to Rev. & Tax. Code section 19133.5.

- 2) A corrected Form 3565 will be issued by FTB to provide that a corporation is required to file Form 3565 for each income year commencing after 1995 during which the corporation issued stock that qualified at the date of issuance as qualified small business stock.
- 3) Failure by a corporation to file Form 3565 alone will not disqualify the stockholder from excluding gain from the sale or exchange of the stock. Whether or not the corporation files Form 3565, the stockholder bears the burden to prove that the stock satisfied the statutory definition of small business stock. Failure by the corporation to file Form 3565 may require the stockholder to gather sufficient information to prove qualification and may result in an audit when the benefits of the statute are claimed.
- 4) A corporation that completes and files Form 3565 should provide a copy of the completed form to each stockholder that acquired stock in the issuance, in accordance with Rev. & Tax. Code section 18125.5(d)(1)(D).

Until such time that the revised Form 3565 is issued, the current form should be used with these modifications. In addition, Rev. & Tax. Code section 18152.5 contains the same provisions of section 1202 of the Internal Revenue Code, which also imposes reporting requirements on the corporation. The provisions of section 3), above, may be revised to conform to any regulations, rulings or procedures issued by the Internal Revenue Service dealing with disqualification of stock under the federal statute.

DRAFTING INFORMATION

The principal author of this notice is Kimberly Mitchell Bott of the Franchise Tax Board Legal Branch. For further information regarding this notice, contact Ms. Bott at the Franchise Tax Board Legal Branch, P.O. Box 1720, Rancho Cordova, CA 95741-1720.