



STATE OF CALIFORNIA  
**FRANCHISE TAX BOARD - Legal Branch**  
PO Box 1720  
Rancho Cordova CA 95741-1720  
(916) 845-3309 Fax (916) 845-3648

STEVE WESTLY  
Chair

CAROLE MIGDEN  
Member

STEVE PEACE  
Member

**May 6, 2003**

**FTB NOTICE 2003-6**

**SUBJECT: PROCEDURES FOR MAKING THE ELECTION TO DEFER CERTAIN GAIN FROM THE SALE OF QUALIFIED SMALL BUSINESS STOCK<sup>1</sup>**

In 1998, Revenue and Taxation Code section 18038.5 was enacted by the Legislature to permit an individual to elect to rollover gain from the sale of "qualified small business stock" if the sale proceeds are used to purchase other "qualified small business stock" within sixty days from the date of the sale. The section applies to sales made after August 5, 1997.

With certain exceptions, California's provisions on small business stock found in Revenue and Taxation Code sections 18038.5 and 18152.5 mirror Internal Revenue Code sections 1045 and 1202, respectively. Due to their similarity and the express intent of the Legislature, any federal rules or procedures applicable to the federal qualified small business stock provisions apply to California's qualified small business stock provisions to the extent that they do not conflict with any California rules or procedures. (See Rev. & Tax. Code, § 18152.5, subd. (I).)

The federal procedure for making an election to rollover gain from the sale of "qualified small business stock" requires the election to be made on an original return filed on or before the due date (including extensions) for filing the income tax return for the taxable year in which the qualified small business stock is sold. (See Rev. Proc. 98-48, 1998-2 C.B. 367.) Therefore, in general, an election under Revenue and Taxation Code section 18038.5 to rollover the gain from the sale of "qualified small business stock" must also be made on an original return filed on or before the due date (including extensions) for filing the income tax return for the taxable year in which the qualified small business stock is sold.

However, the Legislature amended Revenue and Taxation Code section 18038.5 in 2002 in a manner that expanded the types of taxpayers that may elect to rollover gain from the sale of qualified small business stock from only "individuals" to "taxpayers (other than corporations)."<sup>2</sup> (Stats. 2002, ch. 35, § 28 (AB 1122).) Although the

---

<sup>1</sup> "Qualified Small Business Stock" is defined in Revenue and Taxation Code section 18152.5, subd. (c).

<sup>2</sup> "[T]he benefit of a tax-free rollover with respect to the sale of small business stock by a partnership will flow through to a partner who is not a corporation if the partner held its partnership interest at all times the

operative date of the amendment was for sales made after August 5, 1997, under subdivision (c) of the amended statute and section 65 of AB 1122 (Stats. 2002, ch. 35), the legislation that contained the amendment was not enacted by the Legislature until May 8, 2002. As a result, many taxpayers (other than corporations), who were eligible to make the election based upon the 2002 amendment were unable to do so on their original returns because they lacked the statutory authority to do so prior to the amendment.

Therefore, in order to allow taxpayers (other than corporations) to properly elect the benefits of Revenue and Taxation Code section 18038.5, which the Legislature intended to apply to sales of qualified small business stock made after August 5, 1997, the following special procedure applies.<sup>3</sup> For taxable years ending before May 8, 2002, a taxpayer (other than a corporation) may make an election under Revenue and Taxation Code section 18038.5 on an amended return (or untimely original return) filed on or before the earlier of the date of expiration of the statute of limitation on assessment or claim for refund for that taxable year.

The taxpayer (other than a corporation) should make the election by reporting the amount to be deferred on California Schedule D and writing "section 18038.5 election." In addition, the taxpayer should write "filed pursuant to FTB Notice 2003-6" at the top of the amended return.

The principal authors of this notice are Ann Hodges and Bradley Heller of the Franchise Tax Board, Legal Branch. For further information regarding this notice, contact Ms. Hodges or Mr. Heller at the Franchise Tax Board, Legal Branch, P.O. Box 1720, Rancho Cordova, CA 95741-1720.

---

partnership held the small business stock. A similar rule applies to S corporations." (H.R. Conf. Rep. No. 105-599, 2<sup>nd</sup> Sess. (June 24, 1998); See also Rev. & Tax. Code § 18038.5, subd. (b)(5).)

<sup>3</sup> Note that this special procedure does not apply to individual taxpayers because they had the authority to make the election before the revision made by AB 1122, Stats. 2002, ch. 35.