

Expert Report on Valuation of Controlling Shares of Publicly Traded Companies Under the California Billionaire Tax Act (CBTA)

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Summary

This short memo addresses concerns that have been raised under the proposed California Billionaire Tax Act (CBTA or Act) about the valuation of “voting” or “special control” shares, particularly with regard to shares held in publicly traded companies. A misreading of the CBTA is circulating that claims that voting shares of some companies will be taxed at more than their actual value, purportedly resulting in effective tax rates of much greater than the 5% the Act provides. This is false, as shown by a straightforward reading about the provision relating to voting and special control shares in context.

Taxpayers will not be taxed on value that exceeds the market value of their holdings under the CBTA. Publicly traded assets are valued at their fair market value on the valuation date. See Section 50303(c)(1). For other kinds of assets—specifically, for assets that are *not* interests in publicly traded companies or sole proprietorships, Section 50303(c)(3) provides special valuation rules. Taxpayers who believe that an appraisal best represents the value of their asset can submit an appraisal. Alternatively, the taxpayer can rely on the default valuation rules used for assets that lack an appraisal. Among those default valuation rules is a presumption applicable to interests in private entities.¹ The default valuation provision that some on the internet have misread provides that “[f]or any interests that confer voting or other direct control rights, the percentage of the business entity owned by the taxpayer shall be presumed to be not less than the taxpayer’s percentage of the overall voting or other direct control rights.” *Id.* at (c)(3)(C). Neither this default presumption nor any of the default valuation rules of (c)(3) apply to shares of publicly traded entities or to other publicly traded assets, however. Section 50303(c)(3) says expressly that it does not apply to “assets and entities governed by paragraph[] (1) . . .”; i.e., it does not apply to shares in publicly traded entities.

Even in the case of a privately held entity, the default presumption on the valuation of voting or other direct control shares is just that: a default presumption. Again, with respect to any taxpayers or assets to which that presumption is inaccurate or inappropriate, the presumptive value may be rebutted. To rebut, a taxpayer need only demonstrate that the presumption would overstate “the actual value of the business entity owned by the taxpayer or the percentage owned by the taxpayer,” by submitting a certified appraisal of the “actual value” of the asset, which shall then be used to calculate tax owed under the CBTA. See Section 50303(c)(3)(F).

¹ A separate rule applies to sole proprietorships, which is not discussed in more detail here.

To summarize, for ownership interests in privately held businesses (that are not publicly traded or are not sole proprietorships), the Act offers default valuation formulas for administrative convenience. These formulas do not apply to publicly traded entities or other publicly traded assets. Moreover, for privately held entities to which these default presumptive valuation formulas do apply, taxpayers can submit certified appraisals instead of relying on the default valuation formulas. Using certified appraisals for valuation is common in other tax regimes, including the federal estate and gift tax, and is a simple form of proof often used for taxes on high net-worth individuals.

Discussion

Billionaires hold a variety of forms of wealth, and the CBTA provides specific valuation rules for certain categories of assets and businesses. Much of the wealth of billionaires consists of shares that are publicly traded. ***These shares are valued at their market value, under Section 50303(c)(1).*** At Section 50303(c)(2), the CBTA specifies how interests in sole proprietorships are valued. All other interests in business entities—that is, everything “[e]xcept the assets governed by [Section 50303(c)](1) and (2)” —are assigned an initial, presumptive value according to the rules set out in Section 50303(c)(3).

Thus, for privately held businesses, the CBTA uses a default formula to ascertain the values of shares in such a business. See Section 50303(c)(3)(E). There is an additional default formula for valuing “interests that confer voting or other direct control rights” contained within this section (which, again, applies only to the valuation of privately held entities). *Id.* at 50303(c)(3)(C). Using this presumption potentially reduces the need for taxpayers to submit certified appraisals for hard to value assets, which thereby reduces administrative and compliance costs. However, taxpayers may choose to rebut the presumptive valuation by submitting a certified appraisal where a valuation using the default formula would be inaccurate, to avoid paying tax on more than the market value. See Section 50303(c)(3)(F).

For example, suppose that Founder F owns all 1,000 of the supervoting shares of Company C, a company that is not publicly traded. The 9,000 remaining shares of Company C are held by Trust T, which was established by F and F’s spouse for the benefit of their heirs. Because the supervoting shares each have 9 votes, while the remaining shares each have 1, F controls 50% of the voting power for Company C. The default formulaic method results in a default valuation for Company C of \$100 million. The default taxable amount for F is this amount, multiplied by the percentage of the company that F is presumed to own under the default valuation method. Because of the voting stock rule, F is presumed to own no less than F’s portion of the voting power of all shares, so the default valuation of F’s percentage of Company C is 50% of \$100 million, or \$50 million. Recently, however, F pledged some of the supervoting shares as security for a loan, at a valuation of \$15,000 per share. F therefore chooses to submit an appraisal instead of relying on the default valuation method. The appraiser, relying on this recent valuation by an independent third party, reports that F’s stake is worth \$15,000 per share, or \$15 million. F

pays tax only on this \$15 million in value, not the \$50 million default valuation. Since 5% of \$15 million is \$750,000, F's tax is increased by that amount.

Certain publicly traded companies also have shareholders, often founders, with special controlling shares. This is the case, for example, with Alphabet and Meta. But given that such businesses are publicly traded, Section 50303(c)(3)(C) does not apply. The default valuation rule for voting stock in Section 50303(c)(3)(C) was drafted to address certain planning techniques, usually involving trusts, that are engaged in by family-owned businesses (as in the illustration above), and not applicable to public companies. A contrary reading that would apply this rule to public companies would not be viable under the CBTA, which clearly states that the presumption in (c)(3)(C) does not apply to "assets and entities" governed by (c)(1), i.e., to shares in publicly traded entities.

If there were any doubt that voting or control shares of publicly traded businesses are "governed by [Section 50303(c)](1)" and not (c)(3)—which there should not be—the CBTA's definition of "publicly traded asset" at Section 50308(j) includes a catch-all that would lead to the same result, where voting and control shares in publicly traded entities are valued only at their market value. Specifically, that definition includes assets traded on an exchange or on a secondary market with frequently updated sales prices, or "any other asset that the [Franchise Tax] Board determines has a value that is readily ascertainable through similar means." *Id.*

While taxpayers will have to pay tax on the actual value of their shares, they will not have to pay tax on voting shares beyond their market value. Regardless, any argument that founders would be obliged to sell large portions of their company to pay a 5% tax (in 5 annual installments), as some on the internet have claimed, is absurd. A certified appraisal should rebut the presumptive value easily, if the presumption applies. An independent valuation by third parties would establish that the value of the taxpayer's ownership stake was different than provided for in the default rule. As the Act makes clear, an appraisal establishes the value of the taxpayer's particular assets, not just the value of the company in which they own an interest. Thus, the certified appraisal can replace any and all formulaic presumptions.

Finally, the FTB has the power to issue regulations interpreting the CBTA, and [canons](#) of statutory interpretation provide further support that the CBTA is not intended to tax super voting shares beyond their publicly traded value. The revenue scoring for the CBTA is based on the publicly traded value for such shares (see our analysis [here](#), the LAO's fiscal analysis [here](#), and the underlying *Forbes* real-time billionaire list [here](#)). The *Forbes* methodology assumes that super voting shares, when they do not trade publicly, have the same value as publicly traded shares with less voting power (for example to estimate the wealth of Larry Page, Sergei Brin, or Mark Zuckerberg who own super voting shares in Alphabet and Meta). Thus, agencies and the courts should look to how this proposal was scored to understand how it was expected to be implemented.

In short, the plain text of the CBTA shows that the claim that holders of voting or control shares in public companies, or any others, will be taxed beyond the fair market value of their shares is simply false.