

# Instructions for California Schedule D (540)

## California Capital Gain or Loss Adjustment

### General Information

In general, California law conforms to the Internal Revenue Code (IRC) as of January 2005. However, there are continuing differences between California and federal law. When California conforms to federal tax law changes, we do not always adopt all of the changes made at the federal level. For more information, go to our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) and search for **conformity**. Additional information can be found in FTB Pub. 1001, Supplemental Guidelines to California Adjustments, the instructions for California Schedule CA (540 or 540NR), and the Business Entity tax booklets.

The instructions provided with California tax forms are a summary of California tax law and are only intended to aid taxpayers in preparing their state income tax returns. We include information that is most useful to the greatest number of taxpayers in the limited space available. It is not possible to include all requirements of the California Revenue and Taxation Code (R&TC) in the tax booklets. Taxpayers should not consider the tax booklets as authoritative law.

Although federal law increased the IRC Section 179 expense to \$125,000, the maximum deduction amount under California law is \$25,000.

For purposes of California income tax, references to a spouse, a husband, or a wife also refer to a California Registered Domestic Partner (RDP), unless otherwise specified. When we use the initials (RDP) they refer to both a California Registered Domestic "Partner" and a California Registered Domestic "Partnership", as applicable. For more information on RDPs, get FTB Pub. 737, Tax Information for Registered Domestic Partners.

### Purpose

Use California Schedule D (540) **only** if there is a difference between your California and federal capital gains and losses.

Get FTB Pub. 1001, Supplemental Guidelines to California Adjustments for more information about the following:

- Disposition of property inherited before 1987.
- Disposition of S corporation stock acquired before 1987.
- Gain on the sale or disposition of a qualified assisted housing development to low-income residents or to specific entities maintaining housing for low-income residents.
- Capital loss carryback.

**Exclusion of Gain on Qualified Small Business Stock.** California law (R&TC Section 18152.5) provides an exclusion (similar to the federal exclusion under IRC Section 1202) of 50% of the gain on the sale of qualifying small business stock originally issued after 8/10/93 that was held for more than five years. However, for California purposes, at least 80% of the issuing corporation's payroll must be attributable to employment located within California, and at least 80% of the value of the corporation's assets must be used by the corporation to actively conduct one or more qualified trades or businesses in California.

If you have gain on the sale of qualified small business stock that qualifies for the federal Section 1202 exclusion, go to the specific line instructions for line 1b.

**Installment Sales.** If you sold property at a gain (other than publicly traded stocks or securities) and you will receive a payment in a tax year after the year of sale, you must report the sale on the installment method unless you elect not to do so. Get form FTB 3805E, Installment Sale Income. Also, use that form if you received a payment in 2007, for an installment sale made in an earlier year.

You may elect not to use the installment sale method for California by reporting the entire gain on Schedule D (540) (or Schedule D-1 for business assets) in the year of the sale and filing your return on or before the due date.

**At-Risk Rules and Passive Activity Limitations.** If you dispose of (1) an asset used in an activity to which the at-risk rules apply, or (2) any part of your interest in an activity to which the at-risk rules apply, and the

amounts in the activity for which you are not at risk, get and complete federal Form 6198, At-Risk Limitations, using California amounts to figure your California deductible loss under the at-risk rules. Once a loss becomes allowable under the at-risk rules, it becomes subject to the passive activity rules. Get form FTB 3801, Passive Activity Loss Limitations.

### Specific Line Instructions

**Line 1a – List each capital asset transaction.**

**Column (a) – Description of Property.** Describe the asset you sold or exchanged.

**Column (b) – Sales Price.** Enter in this column either the gross sales price or the net sales price. If you received a Form 1099-B, 1099-S, or similar statement showing the gross sales price, enter that amount in column (b). However, if box 2 of Form 1099-B indicates that gross proceeds less commissions and option premiums were reported to the IRS, enter that net amount in column (b). If you entered the net amount in column (b), do not include the commissions and option premiums in column (c).

**Column (c) – Cost or Other Basis.** In general, the cost or other basis represents the cost of the property plus purchase commissions and improvements, minus depreciation, amortization, and depletion. Enter the cost or adjusted basis of the asset for California purposes. Use your records and California tax returns for years before 1987 to determine the California amount to enter in column (c). If you used an amount other than cost as the original basis, your federal basis may be different from your California basis. Other reasons for differences include:

#### Depreciation Methods and Property Expensing

Before 1987, California law disallowed the use of accelerated cost recovery system (ACRS) and disallowed the use of an asset depreciation range 20% above or below the standard rate. Before 1999, California had different limits on the expensing of property under IRC Section 179. California law permits rapid write-off of certain property such as solar energy systems, pollution control devices, and property used in an Enterprise Zone, LAMBRA, Targeted Tax Area, or Los Angeles Revitalization Zone (LARZ).

**Inherited Property** – The California basis of property inherited from a decedent is generally fair market value (FMV) at the time of death.

**S Corporation Stock** – Prior to 1987, California law did not recognize S corporations; therefore, your California basis in S corporation stock may differ from your federal basis. In general, your California basis will be cost-adjusted for income, loss, and distributions received after 1986, while your stock was California S corporation stock. Your federal basis will be cost-adjusted for income, loss, and distributions received during the time your stock qualified for federal S corporation treatment. Effective for taxable years beginning on or after 1/1/02, any corporation with a valid federal S corporation election is considered an S corporation for California purposes. Existing law already requires federal C corporations to be treated as C corporations for California purposes.

**Special Credits** – California law authorizes special tax credits not allowed under federal law or computed differently under federal law. In many instances if you claimed special credits related to capital assets, you must reduce your basis in the assets by the amount of credit.

Other adjustments may apply differently to the federal and California basis of your capital assets. Figure the original basis of your asset using the California law in effect when the asset was acquired, and adjust it according to provisions of California law in effect during the period of your ownership.

**Line 1b – R&TC Section 18152.5 Exclusion.** If the gain qualifying for the IRC Section 1202 exclusion also qualifies for the California exclusion under R&TC Section 18152.5: Enter in column (a) "Section 18152.5 Exclusion." Complete column (b) and column (c) according to the instructions for line 1a. Enter in column (d) the amount of gain

that qualifies for the California exclusion. Enter in column (e) the entire gain realized. **If the gain qualifying for the IRC Section 1202 exclusion does not qualify for the California exclusion:** Complete column (a), column (b), and column (c) according to the instructions for line 1a. Enter -0- in column (d) and enter the entire gain realized in column (e).

**Line 3 – Capital Gain Distributions.** If you receive federal Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains, from a mutual fund, do not include the **undistributed** capital gain dividends on Schedule D. If you receive federal Form 1099-DIV, Dividends and Distributions, enter the amount of **distributed** capital gain dividends.

**Line 6 – 2006 California Capital Loss Carryover.** If you were a resident of California for all prior years, enter your California capital loss carryover from 2006. However, if you were a nonresident of California during any taxable year that generated a portion of your 2006 capital loss carryover, recalculate your 2006 capital loss carryover as if you resided in California for all prior years. Get FTB Pub. 1100, Taxation of Nonresidents and Individuals Who Change Residency, for more information. Enter your California capital loss carryover amount from 2006 on line 6 as a negative number.

**Line 8 – Net Gain or Loss.** If the amount on line 4 is more than the amount on line 7, subtract line 7 from line 4. Enter the difference as a gain on line 8.

If the amount on line 7 is more than the amount on line 4, subtract line 4 from line 7 and enter the difference as a negative amount on line 8.

Use the worksheet on this page to figure your capital loss carryover to 2008.

**Line 9 –** If line 8 is a net capital loss, enter the smaller of the loss on line 8 or \$3,000 (\$1,500 if you are married or an RDP filing a separate return).

**Line 12a –** Compare the amounts entered on line 10 and 11 to figure the adjustment to enter on Schedule CA (540), line 13, column B.

**For example:**

**Loss on line 10 is less than loss on line 11.**

Federal loss on line 10 is . . . . . (\$1,000)  
California loss on line 11 is . . . . . (\$2,000)  
Difference between line 10 and line 11 . . . . . \$1,000

**Gain on line 10 and loss on line 11.**

Federal gain on line 10 is . . . . . \$3,000  
California loss on line 11 is . . . . . (\$3,000)  
Difference between line 10 and line 11 . . . . . \$6,000

**Line 12b –** Compare the amounts on line 10 and 11 to figure the adjustment to enter on Schedule CA (540), line 13, column C.

**For example:**

**Loss on line 10 is more than loss on line 11.**

Federal loss on line 10 is . . . . . (\$2,000)  
California loss on line 11 is . . . . . (\$1,000)  
Difference between line 11 and line 10 . . . . . \$1,000

**Loss on line 10 and gain on line 11.**

Federal loss on line 10 is . . . . . (\$2,000)  
California gain on line 11 is . . . . . \$5,000  
Difference between line 10 and line 11 . . . . . \$7,000

<b>California Capital Loss Carryover Worksheet</b>	
1. Loss from Schedule D (540), line 11, stated as a positive number. . . . .	1 _____
2. Amount from Form 540, line 17 . . . . .	2 _____
3. Amount from Form 540, line 18 . . . . .	3 _____
4. Subtract line 3 from line 2. If less than zero, enter as a negative amount. . . . .	4 _____
5. Combine line 1 and line 4. If less than zero, enter -0-. . . . .	5 _____
6. Loss from Schedule D (540), line 8. . . . .	6 _____
7. Enter the smaller of line 1 or line 5 . . . . .	7 _____
8. Subtract line 7 from line 6. This is your capital loss carryover to 2008 . . . . .	8 _____

## Instructions for Form FTB 3885A

### Depreciation and Amortization Adjustments

#### General Information

In general, California law conforms to the Internal Revenue Code (IRC) as of January 2005. However, there are continuing differences between California and federal law. When California conforms to federal tax law changes, we do not always adopt all of the changes made at the federal level. For more information, go to our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) and search for **conformity**. Additional information can be found in FTB Pub. 1001, Supplemental Guidelines to California Adjustments, the instructions for California Schedule CA (540 or 540NR), and the Business Entity tax booklets.

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Get FTB Pub. 1001, Supplemental Guidelines to California Adjustments, for more information on differences between California and federal law for the following items:

- Amortization of certain intangibles (IRC Section 197)
- Qualified Indian Reservation property
- Grapevines subject to Phylloxera or Pierce's disease
- Additional depreciation

For purposes of California income tax, references to a spouse, a husband, or a wife also refer to a California Registered Domestic Partner (RDP), unless otherwise specified. When we use the initials (RDP) they refer to both a California Registered Domestic "Partner" and a California Registered Domestic "Partnership", as applicable. For more information on RDPs, get FTB Pub. 737, Tax Information for Registered Domestic Partners.

#### Purpose

Use form FTB 3885A **only** if there is a difference between the amount of depreciation and amortization allowed as a deduction using California law and the amount allowed using federal law. California law and federal law have not always allowed the same depreciation methods, special credits, or accelerated write-offs. As a result, the recovery periods or the basis on which the depreciation is figured for California may be different from the amounts used for federal purposes. You will probably have reportable differences if all or part of your assets were placed in service:

- **Before 1/1/87.** California disallowed depreciation under the federal accelerated cost recovery system (ACRS). Continue to figure California depreciation for those assets in the same manner as in prior years for those assets.
- **On or after 1/1/87.** California provides special credits and accelerated write-offs that affect the California basis of qualifying assets. California did not conform to all changes to federal law enacted in 1993; therefore, the California basis or recovery periods may be different for some assets.

- **On or after 9/11/01.** If you claimed the 30% additional depreciation for federal purposes, California has not conformed to the federal Job Creation and Worker Assistance Act of 2002 which allows taxpayers to take an additional first year depreciation deduction and Alternative Minimum Tax depreciation adjustment for property placed in service after September 10, 2001.
- California generally conforms to the federal 2003 increase (IRC Section 280F) for the limitation on luxury automobile depreciation. However, California does not conform to the IRC Section 168(k) provisions (30% and 50% additional first year depreciation). In addition, SUVs and minivans built on a truck chassis are included in the definition of trucks and vans when applying the 6,000 pound gross weight limit.

Differences may also occur for other less common reasons, and the instructions for Schedule CA (540 or 540NR) list them on the line for the type of income likely to be affected. Get FTB Pub. 1001 for more information about figuring and reporting these adjustments.

If reporting a difference for assets related to a passive activity, get form FTB 3801, Passive Activity Loss Limitations, for more information about passive activities.

Do not use form FTB 3885A to report depreciation expense from federal Form 2106, Employee Business Expenses. Instead, see the instructions for Schedule CA (540 or 540NR), line 41.

### Specific Line Instructions

Prepare and file a separate form FTB 3885A for each business or activity on your return that has a difference between California and federal depreciation or amortization. Enter the name of the business or activity in the space provided at the top of the form. If you need more space, attach additional sheets. However, complete Part II, Election to Expense Certain Tangible Property (IRC Section 179), only once.

#### Part I Identify the Activity as Passive or Nonpassive

**Line 1** – Check the box to identify the activity as passive or nonpassive. A passive activity is any activity involving the conduct of any trade or business in which you did not materially participate. Get form FTB 3801 for more information.

If the activity is passive, use this form as a worksheet to figure the depreciation adjustment to carry to form FTB 3801. Beginning in 1994, and for federal purposes only, rental real estate activities of persons in real property business are not automatically treated as passive activities. California did not conform to this provision.

#### Part II Election To Expense Certain Tangible Property

If you qualify, you may elect to expense part of the cost of depreciable personal property used in your trade or business and certain other property described in federal Publication 946, How to Depreciate Property. To qualify, you must have purchased property, as defined in the IRC Section 179(d)(2), and placed it in service during 2007, or have a carryover of unused cost from 2006. If you elect this deduction, you must reduce your California depreciable basis by the IRC Section 179 expense. The maximum Section 179 expense allowed for 2007 is \$25,000.

Complete the worksheet in the next column to figure IRC Section 179 expense for California. Include all assets qualifying for the deduction because the limit applies to all qualifying assets as a group rather than to each asset individually. **Refer to federal Form 4562 for information.**

### Tangible Property Expense Worksheet

<b>1</b>	Maximum dollar limitation for California	<b>1</b>	\$25,000
<b>2</b>	Total cost of Section 179 property placed in service	<b>2</b>	
<b>3</b>	Threshold cost of Section 179 property before reduction in limitation	<b>3</b>	\$200,000
<b>4</b>	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	<b>4</b>	
<b>5</b>	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-	<b>5</b>	
<b>(a) Description of property</b>		<b>(b) Cost</b>	<b>(c) Elected cost</b>
<b>6</b>			
<b>7</b>	Listed property (elected Section 179 cost)	<b>7</b>	
<b>8</b>	Total elected cost of Section 179 property. Add line 6 column (c) and line 7	<b>8</b>	
<b>9</b>	Tentative deduction. Enter the smaller of line 5 or line 8	<b>9</b>	
<b>10</b>	Carryover of disallowed deduction from 2006	<b>10</b>	
<b>11</b>	Enter the smaller of business income (not less than zero) or line 5	<b>11</b>	
<b>12</b>	Section 179 expense deduction for California. Add line 9 and line 10, but do not enter more than line 11. Also, enter the result on form FTB 3885A, line 2	<b>12</b>	
<b>13</b>	Carryover of disallowed deduction to 2008. Add line 9 and line 10. Subtract line 12 from the result	<b>13</b>	

### Part III Depreciation

**Line 3** – Complete column (a) through column (f) for each tangible asset or group of assets placed in service during the tax year. Use the California basis for assets on which you elected to take the Section 179 deduction. It will be the difference between line 6, column (b) and line 6, column (c) of the Tangible Property Expense Worksheet in Part II.

**Line 8a and Line 8b** – Are you using this form as a worksheet in connection with form FTB 3801?

**Yes** Enter the amount from line 8a or line 8b on form FTB 3801, Side 2, California Passive Activity Worksheet, column (e).

**No** Include the amount from line 8a on Schedule CA (540 or 540NR) in column B on line 12 for federal Schedule C activities; on line 17 for federal Schedule E activities; and on line 18 for federal Schedule F activities.

Include the amount from line 8b on Schedule CA (540 or 540NR) in column C on line 12 for federal Schedule C activities; on line 17 for federal Schedule E activities; and on line 18 for federal Schedule F activities.

### Part IV Amortization

**Line 9** – Complete column (a) through column (f) for intangible assets placed in service during the tax year. Use the California basis and the California recovery period.

**Line 14a and Line 14b** – Are you using this form as a worksheet in connection with form FTB 3801?

**Yes** Enter the amount from line 14a or line 14b on form FTB 3801, Side 2, California Passive Activity Worksheet, column (e).

**No** Include the amount from line 14a on Schedule CA (540 or 540NR) in column B on line 12 for federal Schedule C activities; on line 17 for federal Schedule E activities; and on line 18 for federal Schedule F activities.

Include the amount from line 14b on Schedule CA (540 or 540NR) in column C on line 12 for federal Schedule C activities; on line 17 for federal Schedule E activities; and on line 18 for federal Schedule F activities.