TAXABLE YEAR

CALIFORNIA FORM

1994 Investment Interest Expense Deduction 3526

Attach to Form 540, Form 540NR or Form 541.

Name(s) as shown on return

Social security number or F.E.I.N.

1 Investment interest expense paid or accrued in 1994. See instructions	**1**	
2 Disallowed investment interest expense from 1993 form FTB 3526, line 5. If zero or less, enter -0-	**2**	
3 Total investment interest expense. Add line 1 and line 2	**3**	
4 Net investment income. See instructions	**4**	
5 Disallowed investment interest expense to be carried forward to 1995. Subtract line 4 from line 3. If zero or less, enter -0-	**5**	
6 Investment interest expense deduction. Enter the smaller of line 3 or line 4. Form 541 filers, stop here and see instructions. All other filers, go to line 7	**6**	
7 Enter the amount from federal Form 4952, line 8	**7**	
8 Enter the difference between line 7 and line 6. See instructions	**8**	

General Instructions

In general, California did not conform its law to changes made to the Internal Revenue Code (IRC) by the federal Revenue Reconciliation Act of 1993 (Public Law 103-66). California legislation during 1994 did adopt specific provisions of the 1993 federal changes and these provisions are specifically identified when appropriate. All other references in these instructions are to the IRC as it existed on January 1, 1993.

A Purpose of Form

Individuals, estates and trusts that paid interest on a loan allocable to property held for investment (defined on Side 2), may be limited as to the amount of investment interest expense they may deduct. Use form FTB 3526 to figure the amount of investment interest expense deductible for the current year and the amount, if any, to carry forward to future years.

B Who Must File

If you are an individual, estate, or a trust, and you claim a deduction for investment interest expense, you must complete and attach form FTB 3526 to your tax return, unless **all** of the following apply:

- your only investment income was from interest or dividends;
- you have no other deductible expenses connected with the production of interest or dividends;
- your investment interest expense is not more than your investment income; and
- you have no carryovers of investment interest expense from 1993.

Specific Instructions

Generally, California law for the investment interest expense deduction follows federal law. Get the instructions for federal Form 4952, Investment Interest Expense Deduction, for more information. Get federal Pub. 550, Investment Income and Expenses, to determine your investment interest expense deduction if you have interest income or expense attributable to a working interest in oil or gas property; or if you paid or accrued interest on a loan and you used the proceeds of the loan for more than one purpose.

Line 1 – Investment Interest Expense

Enter the investment interest paid or accrued during the tax year, regardless of when you incurred the indebtedness. Investment interest is interest paid or accrued on a loan (or part of a loan) that is allocable to property held for investment. Be sure to include investment interest expense reported to you on Schedule K-1 from a partnership, an S corporation, a limited liability company, or an estate or trust. Include amortization of bond premiums on taxable bonds purchased after October 22, 1986, but before January 1, 1988, unless you elected to offset amortizable bond premiums against the interest payments on the bond. A taxable bond is a bond on which the interest is includible in gross income.

Investment interest expense does not include:

- home mortgage interest;
- interest expense that is properly allocable to a passive activity (see ''Passive Activities'' below);
- any interest expense that is capitalized, such as construction interest subject to IRC Section 263A; or
- interest expense relating to tax-exempt interest income under IRC Section 265.

Passive Activities. A passive activity is any business activity in which you do not materially participate and any rental activity regardless of participation. Investment interest expense does not include any interest expense that is taken into account in determining your income or loss from a passive activity. However, interest expense that is properly allocable to portfolio income is investment interest expense and is not taken into account when determining your income or loss from a passive activity. Portfolio income includes income (not derived in the ordinary course of a trade or business) from interest, dividends, annuities, royalties and net gain from the disposition of property held for investment. For more information about passive activities, get the instructions for federal Schedule E, Supplemental Income and Loss.

Line 4 – Net Investment Income

Note: Beginning in 1993, federal law excludes from gross investment income the amount of net capital gain from the disposition of property held for investment. California law has no such provision.

Figure your total gross investment income (defined below). Subtract your total investment expenses (defined below) from that total and enter the result on line 4. Be sure to include investment income and expenses reported to you on Schedule K-1 from a partnership, an S corporation, a limited liability company, or an estate or trust.

Investment Income. Gross investment income includes income (not derived in the ordinary course of a trade or business) from interest, dividends, annuities, royalties and net gain from the disposition of property held for investment, including capital gain distributions from mutual funds. Net income from the following passive activities is also treated as investment income:

- rental of substantially nondepreciable property;
- equity-financed lending activities; and
- acquisition of certain interests in a pass-through entity licensing intangible property.

In addition to the activities listed above, net passive income from a passive activity of a publicly traded partnership (as defined in IRC Section 469(k)(2)) is also included in gross investment income.

Property Held for Investment. Property held for investment includes property that produces investment income. However, it does not include an interest in a passive activity other than those activities listed above. See ''Passive Activities'' on Side 1 for more information.

Property held for investment also includes an interest in an activity of conducting a trade or business in which you did not materially participate and that is not a passive activity. For example, a working interest in an oil or gas property which is not a passive activity is property held for investment if you did not materially participate in the activity.

Investment Expenses. Investment expenses are your allowed deductions, other than interest expense, directly connected with the production of investment income. For example, depreciation or depletion allowed on assets that produce investment income is an investment expense.

Investment expenses do not include any deductions taken into account in determining your income or loss from a passive activity.

If you have investment expenses that are included as a miscellaneous itemized deduction on federal Schedule A (Form 1040), Itemized Deductions, line 22, you may not have to use all of the amount for purposes of form FTB 3526, line 4. The 2% adjusted gross income limitation on federal Schedule A (Form 1040) may reduce the amount.

To figure the amount you may use, compare the amount of the investment expenses included on federal Schedule A (Form 1040), line 22, with the total miscellaneous expenses on federal Schedule A (Form 1040), line 26. The smaller of the investment expenses included on line 22 or the total of line 26 is the amount you may use to figure the investment expense for form FTB 3526, line 4. If you made adjustments to your miscellaneous expenses on Schedule CA (540 or 540NR), California Adjustments, be sure to include the adjustments in the calculation.

If you have investment expenses reported on a form or schedule other than federal Schedule A (Form 1040), include those expenses when figuring investment expenses for line 4.

Line 6 – Investment Interest Expense Deduction

Form 541 filers should enter the amount on line 6 as a deduction on Form 541, line 10. All other filers must complete line 7.

At-Risk Activities. If any portion of the deductible investment interest expense on line 6 is attributable to an activity for which you are not at risk, you must also complete federal Form 6198, At-Risk Limitations, (using California amounts) to figure your deductible investment interest expense. Get federal Form 6198 and its separate instructions for more information.

After you figure the allowable investment interest expense on form FTB 3526, enter the portion attributable to the at-risk activity on federal Form 6198, line 4. Reduce form FTB 3526, line 6 by the same amount.

Refer to federal Form 6198 and its instructions for more details, especially the instructions for line 4 of that form.

Line 8 – Difference Between California and Federal Deduction

The amount on line 8 is the difference between the deduction allowed by California and the deduction allowed under federal law.

If line 6 is larger than line 7, subtract line 7 from line 6. Enter the result as a positive amount on Schedule CA (540 or 540NR), line 36. Be sure to write ''FTB 3526'' on Schedule CA (540 or 540NR), line 36.

If line 7 is larger than line 6, subtract line 6 from line 7. Enter the result as a negative amount on Schedule CA (540 or 540NR), line 36. Be sure to write ''FTB 3526'' on Schedule CA (540 or 540NR), line 36.

Note: If any portion of your investment interest expense on line 6 is attributable to royalties, enter the difference between the California and federal amounts on Schedule CA (540 or 540NR), line 17, column B or C as appropriate.

Alternative Minimum Tax (AMT). Deductible investment interest expense is an AMT adjustment. Get Schedule P (540, 540NR or 541), Alternative Minimum Tax and Credit Limitations.