

1997 Installment Sale Income

3805E

Attach to your California tax return. Use a separate form for each sale or other disposition of property on the installment method.

Name(s) as shown on tax return Social security no., California corporation no. or FEIN

- 1 Description of property
2a Date acquired (month, day and year)
2b Date sold (month, day and year)
3 Was the property sold to a related party after December 31, 1980?
4 If the answer to the question on line 3 is "Yes," was the property a marketable security?

Part I Gross Profit and Contract Price. Complete this part for the year of sale only.

Table with 18 rows for Gross Profit and Contract Price calculations, including columns for description and numerical values.

Part II Installment Sale Income. Complete this part for the year of sale and any year you receive a payment or have certain debts you must treat as payments on installment obligations.

Table with 10 rows for Installment Sale Income calculations, including columns for description and numerical values.

Part III Related Party Installment Sale Income. Do not complete this part if you received the final installment payment this taxable or income year.

- 27 Name, address and taxpayer identification number of related party
28 Did the related party, during this taxable or income year, resell or dispose of the property ("second disposition")?
29 If you checked "Yes" on line 28, complete lines 30 through 37 below unless one of the following conditions is met.



Table with 7 rows for Related Party Installment Sale Income calculations, including columns for description and numerical values.

Instructions for Form FTB 3805E

Installment Sale Income

References in these instructions are to the Internal Revenue Code (IRC) as of **January 1, 1997**, and to the California Revenue and Taxation Code (R&TC)

General Information

Due to California legislation enacted in 1997, California tax law conforms to the Internal Revenue Code (IRC) as of January 1, 1997, and to selected provisions of the federal Taxpayer Relief Act of 1997 (Public Law 105-34). For example, California law and federal law are the same regarding gain on sale of a personal residence. However, California allows \$13,000 as the maximum IRC Section 179 expense deduction, while the federal maximum is \$18,000.

Purpose

Use form FTB 3805E to report income from casual sales of real or personal property other than inventory if you will receive any payments (including installment payments from sales before 1980) in a year after the year of sale. Do not use this form to report sales after 1986 of stock or securities traded on an established securities market. See IRC Section 453(k).

If any part of an installment payment you received is for interest, be sure to report that interest on the appropriate form or schedule. Do not report interest received, carrying charges received or unstated interest on this form. Get federal Pub. 537, *Installment Sales*, for details on unstated interest.

Do not use form FTB 3805E if you elect not to report the sale on the installment method. Instead, report the sale on your Schedule D, California Capital Gain or Loss Adjustment, or Schedule D-1, Sales of Business Property, whichever applies. See the instructions for Schedule D, or Schedule D-1.

Report the ordinary income from sales of property described in IRC Sections 1245, 1250, 179 and 291 and R&TC Sections 17053.45, 17266, 17267.2, 17268, 23645, 24356.4, 24356.7 and 24356.8 in full in the year of sale even if no payments were received. Figure the ordinary income to be recaptured on Schedule D-1, Part III.

Generally, California law is the same as federal law concerning installment sales. See the instructions for federal Form 6252, *Installment Sale Income*, for more information on how to calculate your installment sale income. You may also refer to IRC Section 453 and R&TC Sections 17551, 17560 and 24667.

Specific Instructions

Which Parts To Complete

For the Year of Sale – Complete line 1 through line 26.

For Years After the Year of Sale – Complete line 1 through line 4 and Part II for any year you receive a payment from an installment sale.

Related Party Sales – If you sold marketable securities to a related party, complete form FTB 3805E for each year of the installment agreement even if you did not receive a payment. See “Installment Sales to Related Party,” to the right, for the definition of a related party. For any year after the year of sale, complete line 1

through line 4, and Part III. If you received a payment, also complete Part II.

If you sold property other than marketable securities to a related party, complete the form for the year of sale and for two years after the year of sale even if you did not receive a payment. If during this two-year period you did not receive an actual or deemed payment, complete line 1 through line 4 and Part III. After this two-year period, see “For Years After the Year of Sale.”

Installment Sales to Related Party

A special rule applies to a first disposition (sale or exchange) of property under the installment method to a related party who then makes a second disposition (sale, exchange, gift or cancellation of installment note) before making all payments on the first disposition. For this purpose, a related party includes your spouse, child, grandchild, parent, brother, sister or a related corporation, S corporation, partnership, limited liability company or estate or trust. See IRC Section 453(f)(1) for more information.

Under this rule, you treat part or all of the amount the related party realized (or the fair market value if the disposed property is not sold or exchanged) from the second disposition as if you received it from the first disposition at the time of the second disposition. Figure the gain, if any, on line 30 through line 37. This rule does not apply if any of the exceptions listed in Part III, line 29 are met.

Sale of Depreciable Property to Related Person

Generally, if you sell depreciable property to a related person (as defined in IRC Section 453(g)(3)), you may not report the sale using the installment method. For this purpose, depreciable property is any property that can be depreciated by the person or entity to whom you transfer it. Related person is defined differently than under the provisions for related party sales. It includes certain controlled entities.

However, you may use the installment method if you can show to the satisfaction of the Franchise Tax Board that avoidance of state income taxes was not one of the principal purposes of the sale (e.g., no significant tax deferral benefit will result from the sale).

If the installment method does not apply, report the sale on Schedule D or Schedule D-1, whichever applies. Treat all payments you will receive as if they were received in the year of sale. Use the fair market value for any payment that is contingent as to amount. If the fair market value cannot be readily determined, basis is recovered ratably.

Pledge Rule

If an installment obligation from a nondealer disposition of real property used in a trade or business or held for the production of rental income with a sales price over \$150,000 is pledged as security on debt after December 31, 1989, treat the net proceeds of the secured debt as a payment on the installment obligation. This rule applies to the disposition of any property under the installment method after 1989 with a sales price over \$150,000, except for farm property and personal use property disposed of by an individual. The amount treated as a payment cannot exceed the excess of the

total contract price over any payments received under the contract before the secured debt was obtained.

The pledge rule does not apply to pledges made after December 31, 1989, if the debt is incurred to refinance the principal amount of a debt that was outstanding on December 31, 1989, AND was secured by nondealer real property installment obligations on that date and at all times after that until the refinancing occurred. However, this exception does not apply to the extent that the principal amount of the debt resulting from the refinancing exceeds the principal amount of the refinanced debt immediately before the refinancing. Also, the pledge rule does not affect refinancing due to the calling of a debt by the creditor as long as the debt is then refinanced by a person other than this creditor or someone related to the creditor.

Interest on Deferred Tax

You must pay interest on the deferred tax from certain installment obligations. (The rules generally apply to dispositions of real property and personal property on or after January 1, 1990.) The interest applies to any installment obligation arising from the disposition of any property under the installment method if:

- The property had a sales price over \$150,000; AND
- The aggregate balance of those obligations arising during, and outstanding at the close of, the taxable or income year is more than \$5 million.

Exception: These rules do not apply to dispositions of farm property or to dispositions of personal use property by an individual.

You must pay interest on the deferred tax from all installment obligations arising from the disposition of timeshares and residential lots. See IRC Section 453(l).

You must pay interest in subsequent years if installment obligations, which originally required interest to be paid, are still outstanding at the close of a taxable or income year.

How to Report the Interest – The interest is not figured on form FTB 3805E. See IRC Section 453A or 453(l)(3) to figure the interest. Substitute the maximum rate of tax imposed under R&TC Section 17041, 23151, 23186 or 23802, whichever applies, for the maximum rate of tax under IRC Section 1 or 11. Enter the interest as an additional tax on your tax return.

Individuals should include the amount on Form 540, line 34 or Form 540NR, line 43. Write "IRC Section 453A interest" or "IRC Section 453 interest" and the amount on the dotted line to the left of the amount.

Corporations may deduct the interest in the year it is paid or accrued. Individuals and other taxpayers may not deduct this interest.

- Line 9 – Depreciation allowed or allowable;
- Line 11 – Commissions and other expenses of sale;
- Line 19 – Gross profit percentage;
- Line 21 – Payments received during year;
- Line 23 – Payments received in prior years; and
- Line 30 – Selling price of property sold by related party.

Line 12 – Figure the amount of recapture on Schedule D-1, Part III and Part IV. See the instructions for Schedule D-1. Enter the part of the gain from the sale of depreciable property recaptured under IRC Sections 1245 and 1250 (as well as IRC Sections 179 and 291) and R&TC Sections 17053.45, 17266, 17267.2, 17268, 23645, 24356.4, 24356.7 and 24356.8.

Line 25

& Line 36 – Report on line 25 or line 36 any ordinary income recapture on IRC Sections 1252, 1254 and 1255 property. This includes recapture for the year of sale or any remaining recapture from a prior year sale. Also report on these lines any ordinary income recapture remaining from prior years on IRC Sections 1245 and 1250 property sold before January 1, 1985. Do not enter ordinary income from an IRC Section 179 deduction. If this is the year of sale, see the instructions for Schedule D-1, Part IV.

The amount on line 25 and line 36 may not exceed the total of the amounts on line 24 and line 35.

Line 26

& Line 37 – **Trade or business property.** Enter this amount on Schedule D-1, line 4, if the property was held for more than one year (more than 6 months if acquired before January 1, 1988). If the property was held one year or less (6 months or less if acquired before January 1, 1988) or if you have an ordinary gain from a noncapital asset, even if the holding period is more than one year, enter the amount on Schedule D-1, line 10, column (h), and write "Form FTB 3805E" to the left of the amount.

Capital assets. Enter this amount on Schedule D, line 1.

Line 29 – If one of the conditions is met, check the appropriate box and skip line 30 through line 37. If you checked box "e," attach an explanation. Generally, the nontax-avoidance condition will apply to the second disposition if the disposition was:

- Involuntary (e.g., a creditor of the related person foreclosed on the property, or the related person declared bankruptcy); or
- An installment sale under which the terms of payment were substantially equal to or longer than those for the first sale. However, the resale terms must not permit significant deferral of recognition of gain from the first sale (e.g., amounts from the resale are being collected sooner).

Specific Line Instructions

Note: If partnerships, S corporations or limited liability companies elect to expense costs under R&TC Section 17266, 17267.2, 17268 or IRC Section 179, then the partners, shareholders or members may not include the expensed costs on line 9.

Refer to federal Form 6252, Installment Sale Income, for information on how to complete the following lines:

- Line 5 – Selling price;
- Line 6 – Mortgage and other debts;
- Line 8 – Cost or other basis of property sold;