

1998 Passive Activity Loss Limitations

3801

Attach to Form 540, 540NR, 541 or 100S (S corporations).

Name(s) as shown on return

Social security number, California corporation no. or FEIN

Part I 1998 Passive Activity Loss

Caution: See the instructions for Worksheet 1 and Worksheet 2 for federal Form 8582 before completing Part I. Be sure to use California amounts.

Rental Real Estate Activities with Active Participation

1a	Activities with net income from Worksheet 1, column (a)	1a			
1b	Activities with net loss from Worksheet 1, column (b).	1b	()	
1c	Prior year unallowed losses from Worksheet 1, column (c). See instructions	1c	()	
1d	Combine line 1a, line 1b and line 1c.	1d			

All Other Passive Activities

2a	Activities with net income from Worksheet 2, column (a)	2a			
2b	Activities with net loss from Worksheet 2, column (b).	2b	()	
2c	Prior year unallowed losses from Worksheet 2, column (c). See instructions	2c	()	
2d	Combine line 2a, line 2b and line 2c.	2d			
3	Combine line 1d and line 2d. If the result is net income or zero, see the instructions for line 3. If line 3 and line 1d are losses, go to line 4. Otherwise, enter -0- on line 9 and go to line 10. See instructions	3			

Part II Special Allowance for Rental Real Estate with Active Participation

Note: Enter all numbers in Part II as positive amounts. See instructions.

4	Enter the smaller of the loss on line 1d or the loss on line 3.	4			
5	Enter \$150,000. If married filing separate, see instructions.	5			
6	Enter federal modified adjusted gross income, but not less than zero. See instructions. Note: If line 6 is equal to or greater than line 5, skip line 7 and line 8, enter -0- on line 9, and then go to line 10. Otherwise, go to line 7	6			
7	Subtract line 6 from line 5.	7			
8	Multiply line 7 by 50% (.50). Do not enter more than \$25,000	8			
9	Enter the smaller of line 4 or line 8	9			

Part III Total Losses Allowed

10	Add the income, if any, from line 1a and line 2a and enter the total	10		
11	Total losses allowed from all passive activities for 1998. Add line 9 and line 10. See the instructions on Side 2 to find out how to report the losses on your tax return	11		

Caution: Worksheets 1 through 6 are not required to be filed with your California tax return and may be detached before filing form FTB 3801. Keep a copy of the worksheets for your records. Refer to the instructions for federal Form 8582 for specific instructions on how to complete the worksheets.

Worksheet 1 For form FTB 3801, line 1a, line 1b and line 1c

Name of activity	Current year		Prior year	Overall gain or loss	
	(a) Net income (line 1a)	(b) Net loss (line 1b)	(c) Unallowed loss (line 1c)	(d) Gain	(e) Loss
Total. Enter on form FTB 3801, line 1a, line 1b and line 1c ▶					

Worksheet 2 For form FTB 3801, line 2a, line 2b and line 2c

Name of activity	Current year		Prior year	Overall gain or loss	
	(a) Net income (line 2a)	(b) Net loss (line 2b)	(c) Unallowed loss (line 2c)	(d) Gain	(e) Loss
Total. Enter on form FTB 3801, line 2a, line 2b and line 2c ▶					

Worksheet 3 Use this worksheet if an amount is shown on form FTB 3801, line 9.

Name of activity	Form or schedule to be reported on	(a) Loss	(b) Ratio	(c) Special allowance	(d) Subtract column (c) from column (a)
Total ▶			1.00		

Worksheet 4 Allocation of Unallowed Losses

Name of activity	Form or schedule to be reported on	(a) Loss	(b) Ratio	(c) Unallowed loss
Total ▶			1.00	

Worksheet 5 Allowed Losses

Name of activity	Form or schedule to be reported on	(a) Loss	(b) Unallowed loss	(c) Allowed loss
Total ▶				

Worksheet 6 Activities With Losses Reported on Two or More Different Forms or Schedules

Name of Activity	(a)	(b)	(c) Ratio	(d) Unallowed loss	(e) Allowed loss
Form or schedule to be reported on: _____					
1a Net loss plus prior year unallowed loss from form or schedule ▶					
b Net income from form or schedule ▶					
c Subtract line 1b from line 1a. If zero or less, enter -0- ▶					
Form or schedule to be reported on: _____					
1a Net loss plus prior year unallowed loss from form or schedule ▶					
b Net income from form or schedule ▶					
c Subtract line 1b from line 1a. If zero or less, enter -0- ▶					
Form or schedule to be reported on: _____					
1a Net loss plus prior year unallowed loss from form or schedule ▶					
b Net income from form or schedule ▶					
c Subtract line 1b from line 1a. If zero or less, enter -0- ▶					
Total. ▶			1.00		

Caution: Worksheets 1 through 6 are not required to be filed with your California tax return and may be detached before filing form FTB 3801. Keep a copy of the worksheets for your records.

1998 Instructions for Form FTB 3801

Passive Activity Loss Limitations

These instructions are based on the Internal Revenue Code (IRC) as of January 1, 1998 and the California Revenue and Taxation Code (R&TC).

General Information

In general, California tax law conforms to the Internal Revenue Code (IRC) as of January 1, 1998. However, there are continuing differences between California and federal tax law. California has not conformed to the changes made to the IRC by the federal Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (Public Law 105-206) and the Tax and Trade Relief Extension Act of 1998 (Public Law 105-277).

Material Participation in Real Property Business (IRC Section 469(c)(7)). 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. As a result, rental activities are passive activities for California purposes.

Expense treatment for small business (IRC Section 179(b)(1)). The maximum allowed under California law is \$16,000; the maximum allowed under federal law is \$18,500.

Amortization of certain intangibles (IRC Section 197). Property classified as IRC Section 197 property under federal law is also IRC Section 197 property for California purposes. There is no separate California election required or allowed. However, for California purposes, in the case of IRC Section 197 property acquired before January 1, 1994, the California adjusted basis as of January 1, 1994, must be amortized over the remaining federal amortization period.

New for 1998

There is a new format for form FTB 3801 and instructions.

- The California Worksheets have been revised to streamline the process of determining the California/federal adjustments.
- Nonpassive activities will be included on the **California Adjustment Worksheets** if the nonpassive activities are reported on the same federal schedule(s) as passive activities.

A Purpose

Individuals, estates, trusts, and S corporations use form FTB 3801 to figure the:

- Allowable California passive activity loss (PAL), and
- Adjustment you must make to account for any difference between your California PAL and your federal PAL.

Generally, California law is the same as federal law concerning PAL limitations. However, differences, such as the special treatment for real estate professionals (as described in the General Information section above) may cause your California PAL to be different than your federal PAL.

B Who Must File

Form FTB 3801 is filed by individuals, estates, trusts and S corporations that have losses (including prior year unallowed losses) from passive activities. (Additional information for nonresidents and S corporations listed below.)

Exception. You do not have to file form FTB 3801 if you meet **both** of the following conditions:

- You have a net loss from rental real estate activities that is fully deductible under the special allowance for rental real estate, **and**
- You have no other passive activities.

Nonresidents

Follow the General Instructions in order to determine your allowable passive activity losses and the amounts to enter on Schedule CA (540NR), column B and column C. Enter your allowable passive activity income and losses (1) from all sources for the period you were a California resident and (2) from California sources for the period during which you were a nonresident on Schedule CA (540NR), column E.

S Corporations

The PAL rules apply as if the S corporation were an individual. For example, losses from passive activities may not be used to offset other income, except for \$25,000 special allowance for losses from active participation rental real estate activities. Refer to IRC Section 469. However, the material participation rules apply as if the S corporation were a closely-held C corporation. The material participation rules for closely-held C corporations are explained in the instructions for federal Form 8810, Corporate Passive Activity Loss and Credit Limitations. Refer to IRC Section 469(h)(4) and the regulations thereunder for more information.

To compute your California PAL for S corporations, use the worksheets to determine the amounts to enter on form FTB 3801 and the S corporation's allowed loss.

Note: For purposes of determining the special allowance for rental real estate, enter the amount from Form 100S, line 21, computed without regard to any passive income (loss), on form FTB 3801, line 6.

The S corporation's PAL adjustment will be the difference between the current year net income (loss) from all passive activities before application of the PAL rules and the total allowable net income (loss) from all passive activities after application of the PAL rules.

The PAL adjustment may be entered on either line 7 or line 13 on Form 100S.

C Coordination with Other Limitations

Generally, losses from passive activities are subject to other limitations, such as basis and at-risk limitations, before they are subject to the passive loss limitations. Once a loss becomes allowable under these other limitations, you must determine whether the loss is limited under the passive loss rules. See the instructions for federal Form 6198, At-Risk Limitations, for details on at-risk rules. However, capital losses that are allowable under the passive loss rules may be limited under the federal IRC Section 1211. Similarly, percentage depletion deductions that are allowable under the passive loss rules may be limited under IRC Section 613A(d).

Note: Complete federal Form 6198 using California amounts before completing form FTB 3801.

Passive Activity Credit Limitations. The following credits may be limited by passive activity income:

- Orphan Drug Credit
 - Low-Income Housing Credit
 - Research Credit
 - Targeted Jobs Credit*
- *For credit generated prior to January 1, 1996.

To determine how much credit is allowed for the current year:

- Individuals, estates, trusts and S corporations use form FTB 3801-CR, Passive Activity Credit Limitations.
- Personal Service Corporations and closely-held corporations subject to the passive loss rules use form FTB 3802, Corporate Passive Activity Loss and Credit Limitations.

D Overview of Form

This form contains 4 steps which are briefly described below:

Step 1

Complete form FTB 3801, Side 2, **California Passive Activity Worksheet**, in order to figure your current year California passive activity income (loss) amounts. You must figure the current year California income (loss) amount for each passive activity before application of the PAL rules.

This may require you to figure the California/federal depreciation or amortization adjustment using form FTB 3885A, Depreciation and Amortization Adjustments.

Step 2

Complete form FTB 3801, Side 1. The result will be your total losses allowed from all passive activities for 1998.

Step 3

Carry the amounts from form FTB 3801, Side 1, to the Worksheets on form FTB 3801, Side 3 and Side 4. You will use these worksheets to compute the allowable loss for each separate passive activity.

Step 4

The net income (loss) for each passive activity will be carried back to the California form or schedule on which it is usually reported. If there are no California forms to carry these amounts to (i.e. amounts from federal Schedules C, E, and F), complete the **California Adjustment Worksheets** on form FTB 3801, Side 2.

If you are completing the **California Adjustment Worksheets**, include any nonpassive activities that are reported on the same federal schedules as the passive activities for which you are completing these worksheets. For example, if you have both passive and nonpassive Schedule E activities, you will include all of them on your **California Adjustment Worksheet, Schedule E Activities**.

By including both your passive and nonpassive activities on the **California Adjustment Worksheets**, you will be able to compute a single adjustment amount to transfer to Schedule CA (540 or 540NR), line 12, line 17, or line 18.

General Instructions

Step 1 — Figuring your California Passive Activity Income (Loss)

Use the **California Passive Activity Worksheet** on form FTB 3801, Side 2, to determine the current year California net income or net loss from each passive activity before application of the PAL rules. Enter information for each passive activity on the schedule separately. The amount to enter in column (d) of the schedule is found on the federal form on which the activity is reported. If you need more space, attach additional sheets.

Example: You reported a rental loss on federal Schedule E. The amount of this loss before the application of the PAL rules is found on federal Schedule E, line 22. You should enter this amount in column (d) of the worksheet.

Note for partners, members of limited liability companies (LLCs) and shareholders of S corporations: If you do not materially participate in the activity of a partnership, LLC, or S corporation in which you hold an interest and you determine the activity is passive, skip Step 1 and use the California amount from your Schedule K-1, column (d), to complete Worksheet 1 and Worksheet 2 on form FTB 3801, Side 3.

Step 2 — Completing form FTB 3801, Side 1

Use the amount from the **California Passive Activity Worksheet**, column (f) to complete

form FTB 3801, Side 3, Worksheet 1 and Worksheet 2. These worksheets will determine the amounts to enter on form FTB 3801, Side 1, lines 1a, 1b, 2a, and 2b. Complete form FTB 3801, Side 1 as follows:

Part I

Enter the amounts from form FTB 3801, Side 3, Worksheet 1 and Worksheet 2.

See the instructions for federal Form 8582 for specific line instructions and examples.

Line 3

If line 3 shows income, all of your losses are allowed, including any prior year unallowed losses entered on line 1c or line 2c. Transfer the income and losses to the form or schedule on which you normally report them. See "Figuring the California Adjustment" in Step 4.

Part II

Enter all numbers in Part II as positive amounts. See the instructions for federal Form 8582 for specific line instructions and examples.

Line 5

Married persons filing separate returns who lived apart at all times during the year should enter \$75,000 on line 5 instead of \$150,000. Married persons filing separate returns who lived together at any time during the year are not eligible for this special allowance. They must enter -0- on line 9 and go to line 10.

Line 6

Enter your modified federal adjusted gross income from federal Form 8582, line 6.

If you did not complete federal Form 8582, see the instructions for federal Form 8582 for how to figure your modified adjusted gross income.

S Corporations: Enter the amount from Form 100S, California S Corporation Franchise or Income Tax Return, line 21 computed without regard to any passive income (loss).

Publicly Traded Partnerships (PTPs)

A PTP is a partnership whose interests are traded on an established securities market or are readily tradable on a secondary market (or the substantial equivalent). See the information provided for PTPs in the instructions for federal Form 8582 for an explanation of established securities market and secondary market. Also, information which you receive from your partnership will usually indicate whether or not your partnership interest is an interest in a PTP. If you have income or loss from a PTP, see below. All others go to Step 3.

Passive activity loss rules for partners in PTPs

Passive losses from a PTP can only offset income from the same PTP. Therefore, do not include passive income, gains, or losses from a PTP on form FTB 3801, Side 1. Instead, use the following steps to figure and report your income, gains and losses from PTPs:

1. Combine current year income, gains, losses and prior year unallowed losses from each activity of the PTP. Determine whether you have an overall gain (total gain/income minus total losses) or an overall loss.
2. If you have an overall gain, the overall gain is nonpassive income. The remaining gain is gain or income from a passive activity and the total loss is a loss from a passive activity.
3. If you have an overall loss (but did not dispose of your interest in the PTP to an unrelated person in a fully taxable transaction during the year), the net loss is disallowed and carried to the next year. All income or gain is income or gain from a passive activity and losses equal to the amount of income or gain reported is loss from a passive activity.
4. Report all gain or income and any allowed losses on the forms or schedules where the type of gain, income or loss would usually be reported. For example, a gain from the sale of business property (IRC 1231 gain) would be reported on California Schedule D-1. Write "From PTP" to the left of the amount.

Remember to use California amounts. Include only the same types of income and losses you would include in figuring your net income or loss from a non-PTP passive activity. For amounts reportable on Schedule E, you will need to use California Adjustment Worksheet, Schedule E Activities. See Step 4 - Figuring the California Adjustment.

Example: You own an interest in a PTP. The PTP reports ordinary income of \$8,000 for federal purposes and ordinary income of \$7,000 for California purposes. The PTP has a prior year IRC Section 1231 unallowed loss of \$3,500 for federal purposes and a prior year IRC Section 1231 (California conforming RT&C Section 18151) loss of \$5,000 for California purposes. You have an overall gain of \$4,500 (8,000 - 3,500) for federal purposes and overall gain of \$2,000 (7,000 - 5,000) for California purposes. You would report "From PTP" \$5,000 loss on California Schedule D-1. The difference between the California loss of \$5,000 and the federal loss of \$3,500 would be included in the California adjustment on California Schedule D or California Schedule D-1. You would report the following on your California Adjustment Worksheet, Schedule E Activities (FTB 3801, Side 2):

(a) Schedule E Activities	(b) Passive or Nonpassive	(c) California Amount	(d) Federal Amount
"From PTP"	Nonpassive	\$2,000	\$4,500
"From PTP"	Passive	\$5,000	\$3,500

Step 3 — Completing the Worksheets on Form FTB 3801, Side 3 and Side 4

After you have completed form FTB 3801, Side 1, complete Worksheets 3, 4 and 5 or 6.

How to Report Allowed Losses

See the instructions for federal Form 8582, "How to Report Allowed Losses." Follow the instructions and use Worksheet 5 and Worksheet 6 to identify the amount of allowed losses from each activity.

Step 4 — Figuring the California Adjustment

After you have completed the Worksheets on Side 3 and Side 4 of form FTB 3801 and you have determined the amount of PAL allowed for each activity, you will need to figure your California Adjustment.

If California has a separate form or schedule to figure the California Adjustment, use it to compute the amount of the California Adjustment. Include the allowed losses from Worksheet 5 or Worksheet 6 on the California form(s) or schedule(s) on which they are normally reported. For example, California Schedule D is comparable to federal Schedule D, and California Schedule D-1 is comparable to federal Form 4797.

Where there are no comparable California forms or schedules, use the **California Adjustment Worksheets** on form FTB 3801, Side 2. Specifically, California does not have forms or schedules comparable to federal Schedules C, E, or F. Each PAL that has no comparable California form or schedule should be listed on the **California Adjustment Worksheet** corresponding to the federal schedule where it was reported.

Note: Remember to include nonpassive activity amounts when the nonpassive activities are reported on the same federal schedule as those activities that are passive for California.

Using the California Adjustment Worksheets: Complete column (a) through column (d) of each worksheet. Group all activities from each type of federal schedule on the appropriate worksheet as indicated in column (a). If you need more space, attach additional sheets.

Column (a): Enter a description of the activity. Include **passive and nonpassive activities** that are reported on the same federal schedule. For example, if you have one federal Schedule E activity that is passive for California and one Schedule E activity that is nonpassive for California, include both activities and their corresponding amounts on the **California Adjustment Worksheet, Schedule E Activities**.

Column (b): Enter the character of the activity for California purposes as passive or nonpassive.

Column (c): Enter your California net income (loss) from this activity after application of the PAL rules. This will be the amount of any overall gain from Worksheet 1 and Worksheet 2 and allowed losses from Worksheet 5 and Worksheet 6.

Column (d): Enter the federal net income (loss) from this activity **after** application of the PAL rules (e.g. Schedule C, line 31, Schedule E income, line 22, Schedule E loss, line 23, and Schedule F, line 36).

Note: If you have an activity that is nonpassive for federal purposes and passive for California purposes (as in the case of rental real estate professionals), use the actual allowable federal amounts in column (d) of the **California Adjustment Worksheets**.

Complete each **California Adjustment Worksheet** as follows:

1. Add the column (c) amounts and enter the results on the Total line for column (c).
2. Add the column (d) amounts and enter the results on the Total line for column (d).
3. Subtract the Total amount of column (d) from the Total amount of column (c) and enter the difference on the Total column (e) line.
4. CA Adjustment (column (e)):
 - If the Total column (e) amount is positive, you have a California addition. Enter this amount on Schedule CA (540 or 540NR) as follows:

California Adjustment Worksheet	Schedule CA (540 or 540NR)
Total, column 1(e) –	line 12, Column C.
Total, column 2(e) –	line 17, Column C.
Total, column 3(e) –	line 18, Column C.

- If the Total column (e) amount is negative, you have a California subtraction. Enter this amount on Schedule CA (540 or 540NR) as follows:

California Adjustment Worksheet	Schedule CA (540 or 540NR)
Total, column 1(e) –	line 12, Column B.
Total, column 2(e) –	line 17, Column B.
Total, column 3(e) –	line 18, Column B.

Note: Enter all amounts on Schedule CA (540 or 540NR) as positive amounts.

See the example on the following page for an illustration of how to complete the **California Adjustment Worksheets**. For purposes of this illustration, Step 1 through Step 3 in the General Instructions for form FTB 3801 have already been completed.

Example:

Barbara is a real estate professional who qualifies to apply the IRC Section 469(c)(7) special rules for taxpayers in real property business. Barbara has elected to treat all interests in rental real estate as one activity and Barbara has determined that she materially participates in this one activity. Therefore, the losses from Barbara's three rental properties are characterized as nonpassive for federal purposes. However, since California does not conform to IRC Section 469(c)(7), these losses are characterized as passive for California purposes. Barbara is also a general partner in a real estate development activity in which she materially participates. Barbara has a federal modified adjusted gross income of \$85,000. Barbara's activities and the federal schedules she reports them on are as follows:

- Rental Property A, Schedule E
- Rental Property B, Schedule E
- Rental Property C, Schedule E
- XYZ Partnership, Schedule E

Having completed Step 1 through Step 3 of the General Instructions to form 3801, Barbara completes the **California Adjustment Worksheet for Schedule E Activities** as explained in Step 4. This is illustrated in the partial view of the **California Adjustment Worksheets** below:

(a) Schedule E Activities	(b) Passive or Nonpassive	(c) California Amount	(d) Federal Amount	(e) California Adjustment
Rental Property A	Passive	-13,561	-25,000	If the amount below is positive , enter the amount on Schedule CA (540 or 540NR) line 17, Column C.
Rental Property B	Passive	- 6,442	-12,000	
Rental Property C	Passive	- 4,997	-10,000	
XYZ Partnership	Nonpassive	-20,000	-20,000	
				If the amount below is negative , enter the amount on Schedule CA (540 or 540NR) (as a positive amount) on line 17, Column B.
Total		2(c) -45,000	2(d)** -67,000	2(e) 22,000

**This amount should be the same as the amount reported on Schedule CA (540 or 540NR), column A, line 17.

Schedule CA Adjustment: Since the amount in column 2(e) is positive, Barbara will enter \$22,000 on Schedule CA (540 or 540NR), line 17, column C.