

Instructions for Schedule D-1

Sales of Business Property

(Also, involuntary conversions and recapture amounts under IRC Sections 179 and 280F and R&TC Sections 17267.2, 17267.6, 17268, 24356.5, 24356.6, 24356.7, and 24356.8). References in these instructions are to the Internal Revenue Code (IRC) as of **January 1, 2001**, and to the California Revenue and Taxation Code (R&TC).

General Information

In general, California law conforms to the Internal Revenue Code (IRC) as of January 1, 2001. However, there are continuing differences between California and federal law. It should be noted that California does not always conform to the entire provisions of a public law. California has conformed to some of the changes made to the Internal Revenue Code after January 1, 2001, including some provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), the Victims of Terrorism Tax Relief Act of 2001 (Public Law 107-134), and the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147). California has not conformed to any of the provisions of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (Public Law 108-27) and the Military Family tax relief Act of 2003 (Public Law 108-121).

For taxable years beginning on or after January 1, 2002, California law was changed to clarify the method used to calculate loss carryovers, deferred deductions, and deferred income for nonresident and part-year resident taxpayers. This changed the tax computation to recognize those items, and established a new method to determine percentages for computing tax for all nonresidents and part-year residents. The nonresident tax forms (Long and Short Form 540NR) have been revised to more clearly show that nonresidents pay tax to California only on their California taxable income. For further information, get FTB Pub. 1100, Taxation of Nonresidents and Individuals Who Change Residency.

A Purpose

Use Schedule D-1 to distinguish IRC Section 1231 property between ordinary loss and capital gain.

Complete and attach this form to your return **only** if your California gains or losses from the sale or exchange of assets used in a trade or business are different from your federal gains or losses. (For common examples of items to report on this schedule, see the instructions for federal Form 4797, Sales of Business Property.)

Use this form to report:

1. The sale or exchange of:
 - Trade or business property;
 - Depreciable and amortizable property;
 - Oil, gas, and geothermal property; and
 - IRC Section 126 property.
2. The involuntary conversion (other than casualty or theft) of trade or business property and capital assets held in connection with a trade or business or a transaction entered into for profit.

3. The disposition of noncapital assets (other than inventory or property held primarily for sale to customers in the ordinary course of your trade or business).
4. The disposition of capital assets not reported on Schedule D (100, 100W, 100S, 540, or 540NR).
5. The recapture of IRC Section 179 and R&TC Sections 17267.2, 17267.6, and 17268 deductions for partners, members, and shareholders from property distributions by partnerships, limited liability companies (LLCs) (classified as partnerships), and S corporations, respectively. See IRC Section 179 Recapture under General Information B, Special Rules, for the reporting requirements.
6. The computation of recapture amounts under IRC Sections 179 and 280F when the business use of IRC Section 179 or 280F property drops to 50% or less and for property that ceases to be "qualified property" under R&TC Sections 17267.2, 17267.6, 17268, 24356.5, 24356.6, 24356.7, and 24356.8.

B Special Rules

Combined Reporting Groups. Each corporation that is a member of a combined reporting group should complete this form to report its share of business gains and losses apportioned to California and its nonbusiness gains and losses that are allocated to California. For more information, see Cal. Code Regs., tit. 18 section 25106.5-2 and FTB Pub. 1061, Guidelines for Corporations Filing a Combined Report.

Casualties and Thefts. Complete federal Form 4684, Casualties and Thefts, using California amounts.

Exchange of "Like-Kind" Property. Complete and attach federal Form 8824, Like-Kind Exchanges, using California amounts.

Report the exchange of like-kind property, even if no gain or loss is recognized. Write "Like-Kind Exchange from Form 8824" as the property description, and enter the gain or loss, if any, from Form 8824 (using California amounts) on line 5 or line 16, whichever applies. If an exchange was made with a related party, write "Related Party Like-Kind Exchange" in the top margin of Schedule D-1.

Installment Sales. If you sold property at a gain 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.

If you are a nonresident or part-year resident, your calculation may change as a result of Assembly Bill 1115 (Stats. 2001, Ch. 920). Get FTB Pub. 1100, Taxation of Nonresidents and Individuals Who Change Residency.

Use form FTB 3805E, Installment Sale Income, to report the sale on the installment method. Also use form FTB 3805E to report any payment received in 2003 from a previous installment sale.

If you elect not to use the installment method for California, report the full amount of the gain on a timely filed return (including extensions).

Property subject to IRC Section 179 Expense Deduction Recapture. If you have a gain from the sale, exchange or disposition for which an IRC Section 179 expense deduction was claimed in a prior year, special rules apply. Partnerships, partners, members, and shareholders should follow the instructions in federal Form 4797.

LLCs and S corporations should follow the instructions in federal Form 4797 **with the exception** that the amount of gain on property subject to the IRC Section 179 recapture must be included in the total income for the LLC and the taxable income for the S corporation.

- LLCs report the gain on property subject to the IRC Section 179 recapture on line 17d of the Limited Liability Company Income Worksheet.
- S corporations report the gain on property subject to the IRC Section 179 recapture on Form 100S, line 7.

Note: The gain on property subject to the IRC Section 179 recapture should be reported on the Schedule K and Schedule K-1 as supplemental information as instructed on the federal Form 4797.

The LLC or the S corporation must provide the following information with respect to a disposition of business property if an IRC Section 179 expense deduction was claimed in prior years:

- a. Description of the property.
- b. Date the property was acquired.
- c. Date the property was sold.
- d. Gross sales price.
- e. Cost or other basis plus expense of sale (not including the entity's basis reduction in the property due to IRC Section 179 expense deduction).
- f. Depreciation allowed or allowable (not including the IRC Section 179 expense deduction).
- g. Amount of IRC Section 179 expense deduction (if any).
- h. An indication if the disposition is from a casualty or theft.
- i. If this is an installment sale, any information needed to complete form FTB 3805E, Installment Sale Income.

Passive Loss Limitations. If you are a nonresident or part-year resident, your calculation may change as a result of Assembly Bill 1115 (Stats. 2001, Ch. 920). Get

FTB Pub. 1100, Taxation of Nonresidents and Individuals Who Change Residency.

If you have an overall loss from passive activities and you report a loss on an asset used in a passive activity, use form FTB 3801, Passive Activity Loss Limitations, or form FTB 3802, Corporate Passive Activity Loss and Credit Limitations, to see how much of the loss is allowed before entering it on Schedule D-1. Gains from assets used in a passive activity should be reported on Schedule D-1 but should also be reported on form FTB 3801 or form FTB 3802 to offset losses, if any, from other passive activities.

Unused passive activity credits are not allowable when you dispose of part of your interest in an activity. If you dispose of your entire interest in an activity, get the instructions for federal Form 4797 for more information.

IRC Section 197(f)(9)(B)(ii) Election. If you elected to recognize gain on the disposition of a Section 197 intangible and to pay the tax on the gain at the highest tax rate, report the additional tax on Form 540, line 36 (or the appropriate line of other income tax returns). Write "IRC Section 197" and the amount of the Section 197 tax on the dotted line to the left of the amount.

For information about at-risk rules and the exclusion of gain on the sale of a home used for business, get the instructions for federal Form 4797.

Specific Instructions

Part I

Use Part I to report sales or exchanges of trade or business property and certain involuntary conversions, such as condemnations of trade or business property and of capital assets held more than one year. If any of the recognized losses were from involuntary conversions arising from fire, storm, shipwreck, or other casualty or from theft, and they exceed the recognized gains from the conversions, do not include them when figuring your nonrecapture net IRC Section 1231 losses. You may have to complete Part III before you complete Part I if depreciable and certain amortizable property, farm property, or oil or gas property was disposed of at a gain. For examples of IRC Section 1231 transactions, see the instructions for federal Form 4797.

Line 2, column (f) – Other basis means a basis other than cost. There are times when you cannot use the cost of the property as the basis. For example, in situations involving like-kind exchanges, the basis generally will be the basis of the property given up in the exchange. Under other circumstances, you may be required to use the fair market value of your property. However, you may have been required to reduce the basis for California purposes. For example, if you took the business expense deduction for enterprise zones (including former program areas) or a

local agency military base recovery area, you may be required to make a basis adjustment. For more information about the differences in California and federal basis, get FTB Pub. 1001, Supplemental Guidelines to California Adjustments.

Line 8 – Part or all of your IRC Section 1231 gains on line 7 may be taxed as ordinary income instead of receiving capital gain treatment. These net IRC Section 1231 gains are treated as ordinary income to the extent of the "nonrecaptured IRC Section 1231 losses." The nonrecaptured IRC Section 1231 losses are net IRC Section 1231 losses deducted during the five preceding tax years that have not yet been applied against any net IRC Section 1231 gain to determine how much gain is ordinary income under these rules. Treat the amount of loss as a positive number.

Figuring the Prior Year Losses.

You had a net IRC Section 1231 loss if your IRC Section 1231 losses exceeded your IRC Section 1231 gains. Gains are included only to the extent taken into account in figuring gross income. Losses are included only to the extent taken into account in figuring taxable income, except that the limitation on capital losses does not apply. See IRC Sections 1231(c)(5) and 1231(a)(4).

Line 9 – If line 9 is zero, enter the amount from line 7 on line 12. All of your IRC Section 1231 gain is treated as ordinary income. For record keeping purposes, the amount on line 7 is also the amount of net IRC Section 1231 loss recaptured in 2003.

Part II

If a transaction is not reportable in Part I or Part III and the property is not a capital asset reportable on Schedule D (100, 100W, 100S, 540, or 540NR), report the transaction in Part II.

Line 10 – Report other ordinary gains and losses, including property held one year or less, on this line.

Individuals also report ordinary losses from the sale or exchange (including worthlessness) of IRC Section 1244 (small business) stock on this line.

Line 12 – If line 9 is zero, enter the amount from line 7. If line 9 is more than zero, enter the amount from line 8.

Line 15 – Enter any ordinary gain from installment sales from form FTB 3805E, line 25 or line 36. This line applies only to sales of IRC Sections 1252, 1254, and 1255 property and IRC Sections 1245 and 1250 property if you are still reporting ordinary gain from sales before 6/7/84.

Line 17 – Enter any recapture of IRC Section 179 or R&TC Sections 17267.2, 17267.6, and 17268 expense included on Schedule K-1 (565 or 568), line 22, or on Schedule K-1 (100S), line 23, but only if it is due to a disposition. Include it only to the extent that you took a deduction for it in an earlier year. See the instructions for Part IV if you have IRC Section 179 recapture when the business

use percentage of the property drops to 50% or less, or if you have R&TC Section 17267.2, 17267.6, 17268, 24356.5, 24356.6, 24356.7, or 24356.8 recapture when the property ceases to be qualified property.

Note: If the gain subject to IRC Section 179 expense deduction recapture pertains to disposition of property by a partnership, LLC or S corporation, see the instructions under General Information B, Special Rules.

Line 18 – Enter the difference between ordinary federal gains or (losses) from line 18 on your return as follows:

Corporations: Form 100 or Form 100W, line 8, other additions; or line 16, other deductions.

Exempt Organizations: Form 109, Part I, line 4b, net gain (loss).

S corporations: Form 100S, line 7, other additions; or line 13, other deductions. Also, see instructions for Schedule K (100S), line 5 and line 6.

Built-in Gains. For California purposes, when a C corporation elects to be an S corporation, certain items recognized in S corporation years are subject to the C corporation tax rate instead of the S corporation tax rate.

Built-in gains are reported on Schedule D (100S), S Corporation Capital Gains and Losses and Built-In Gains. Get the Form 100S Booklet for additional information.

Partnerships and Limited Liability Companies: See instructions for Schedule K and Schedule K-1 (565 or 568), line 6 and line 7.

Line 18b(1) – If the amount of your California casualty and theft loss is not the same as the amount of your federal casualty and theft loss, enter the difference on Schedule CA (540 or 540NR), California Adjustments, line 38.

Line 21 – Compare your federal amount entered on line 19 with your California amount entered on line 20. If the amount on line 19 is more than the amount on line 20, enter the difference on line 21(a) and on Schedule CA (540 or 540NR), line 14, column B. If the amount on line 20 is more than the amount on line 19, enter the difference on line 21(b) and on Schedule CA (540 or 540NR), line 14, column C.

Part III

Generally, do not complete Part III for property held one year or less; use Part II instead.

Part III is used to compute recapture of depreciation and certain other items that must be reported as ordinary income upon the disposition of property. Complete line 22 through line 27 to determine the gain on the disposition of the property. If you have more than 4 transactions to report, use additional forms.

For examples of IRC Sections 1245, 1250, 1252, 1254, and 1255 property, see instructions for federal Form 4797.

Line 25 – Taxpayers other than partnerships, LLCs, or S corporations, complete the

following steps to figure the amount to enter on line 25.

- **Add** depreciation or depletion allowed or allowable, amortization or ACRS deductions if it is recovery property.
- **Add** the IRC Section 179 expense and R&TC Sections 17267.2, 17267.6, 17268, 24356.5, 24356.6, 24356.7, and 24356.8 expenses deducted.
- **Subtract** any IRC Sections 179 and 280F recapture amount included in gross income in a prior taxable year because the business use of the property dropped to 50% or less. Also subtract any R&TC Sections 17267.2, 17267.6, 17268, 24356.5, 24356.6, 24356.7, and 24356.8 recapture amount included in gross income in a prior taxable year because the property ceased to be qualified property.

Note: Use the amount claimed on your California return under R&TC Section 17201 when adding or subtracting IRC Section 179 expense.

You may have to include depreciation allowed or allowable on another asset (and recompute the basis amount for line 24) if you use its adjusted basis in determining the adjusted basis of the property described on line 22. An example is property acquired by a trade-in. (See Section 1.1245-2(a)(4) of the federal regulations.)

Partnerships, LLCs and S corporations that sale, exchange or otherwise dispose of property for which an IRC Section 179 expense deduction was previously passed through to the partners, members, or shareholders, see the instructions under General Information B, Special Rules.

In all other cases, partnerships and LLCs should enter the depreciation or depletion allowed or allowable or amortization on line 25. Enter any IRC Section 179 and R&TC Sections 17267.2, 17267.6, and 17268 expenses on Schedule K-1 (565 or 568), line 22.

In all other cases, S corporations should enter the depreciation or depletion allowed or allowable, amortization, ACRS or MACRS deductions on line 25. Enter any IRC Section 179 and R&TC Sections 17267.2, 17267.6, and 17268 expenses on Schedule K-1 (100S), line 23.

IRC Section 1245 Property

California law generally is the same as federal law. See federal Form 4797 for examples of IRC Section 1245 property.

IRC Section 1250 Property

California law generally is the same as federal law except for certain modifications to IRC Section 1250(b). See R&TC Section 18171.

Line 29a – Enter the additional depreciation for the period after 12/31/76. For IRC Section 1250 property held more than one year, additional depreciation is the excess of actual depreciation over depreciation figured using the straight-line method. For IRC Section

1250 property held one year or less, all depreciation is additional depreciation.

Line 29b – Use 100% as the percentage for this line unless you have low-income rental property described in IRC Section 1250(a)(1)(B).

Line 29d – Enter the additional depreciation after 12/31/70 and before 1/1/77. If the straight-line depreciation is more than the additional depreciation after 12/31/70 and before 1/1/77, reduce line 29a by the excess amount, but not below zero.

Line 29f – Refer to the instructions for federal Form 4797, line 26f. California law generally follows IRC Section 291 except IRC Sections 291(a)(3) and 291(b)(1) have been modified. Enter the ordinary income amount computed according to the federal instructions using California figures.

IRC Section 1252 Property

Partnerships, skip line 30a through line 30c. Partners should enter on the applicable lines of Part III amounts subject to IRC Section 1252 according to instructions from the partnership.

You may have ordinary income on the disposition of certain farm land held more than one year but less than 10 years.

Gain from disposition of certain farm land is subject to ordinary income rules under IRC Section 1252 before being considered under IRC Section 1231 (Part I).

Line 30b – Enter 100% of line 30a on line 30b if your property was held for 10 years or longer. If your property was held for less than 10 years, use the same percentage required by federal law.

Part IV

Complete column (a) of line 36 through line 38 of Part IV to figure the amount to be recaptured if:

- You took a deduction under IRC Section 179 for property placed in service on or after 1/1/87 [other than listed property, as defined in IRC Section 280F (d)(4)]; and
- The property was not used predominantly in your trade or business at any time; **or**
- You took a deduction under R&TC Section 17267.2, 17267.6, 17268, 24356.5, 24356.6, 24356.7, or 24356.8; and
- That property ceased to be qualified property before the close of the second taxable year after it was placed in service.

IRC Section 280F Property. If you have listed property that you placed in service in a prior year and the business use dropped to 50% or less this year, figure the amount to be recaptured. Complete column (b), line 36 through line 38, of Part IV.

Note: If you have more than one property subject to the recapture rules, use separate statements to figure the recapture amounts for each property and attach the statements to your return.

Line 36, Column (a) – Enter the IRC Section 179 expense claimed on your California return under R&TC Section 17201, and R&TC Sections 17267.2, 17267.6, 17268, 24356.5, 24356.6, 24356.7, and 24356.8 expenses that were deducted when the property was placed in service.

Column (b) – Enter the recovery deductions allowable on the property in prior tax years. Any deduction allowable under IRC Section 179 on that property is treated as if that deduction was a recovery deduction under IRC Section 168.

Line 37, Column (a) – Enter the depreciation allowable on the IRC Section 179 amount from the time it was placed in service (on or after 1/1/87) or, under R&TC Sections 17267.2, 17267.6, 17268, 24356.5, 24356.6, 24356.7, and 24356.8, from the time the property was placed in service to the current year.

Column (b) – Enter the recovery deductions that would have been allowed if the property had not been predominantly used in a qualified business. Figure the deductions from the year it was placed in service to the current year.

Line 38 – If the recapture amount on your federal Form 4797, Part IV, line 35, is different from the recapture amount on Schedule D-1, line 38, an adjustment is required on your California return as follows:

Individuals: Figure the difference between the federal amount and the California amount, and enter on the line for reporting the type of business income that resulted in the recapture on Schedule CA (540 or 540NR) as follows:

- If the federal amount is more than the California amount, enter the difference on Schedule CA, column B.
- If the California amount is more than the federal amount, enter the difference on Schedule CA, column C.

Corporations: Form 100 or Form 100W, line 8, other additions; or line 16, other deductions for the difference between California and federal recapture amounts.

S corporations: Form 100S, line 7, other additions; or line 13, other deductions for the difference between California and federal recapture amounts. Also, Schedule K (100S) and Schedule K-1 (100S), line 6 or line 10.

Partnerships or Limited Liability Companies: Schedule K (565 or 568) and Schedule K-1 (565 or 568), line 7 or line 11.