

**FRANCHISE TAX BOARD
CALIFORNIA CODE OF REGULATIONS TITLE 18, DIVISION 3,
CHAPTER 2.5, SUBCHAPTER 11, SECTION 17951-7
REGARDING TAX DEFERRED EXCHANGES OF REAL PROPERTY**

PLEASE NOTE: Proposed additions to regulatory text in Section 17951-7 from the previous version noticed on August 21, 2024, are shown in Double Underline. Proposed deletions are shown in ~~Double Strikethrough~~.

Regulation 17951-7 is modified to read:

17951-7. ~~Deferred gGains andor lLosses Involvingfrom exchanges of rReal or tangible pProperty from Sources within in this sState.~~

(a) *In General.* When Ggain or loss realized is recognized for federal income tax purposes on the exchange, sale, or other disposition of real property that is, or has been involved and deferred upon the voluntary or involuntary disposition of real or tangible personal property located in this State in an exchange that qualifies for deferral under section 1031 or section 1033 of the Internal Revenue Code or involved in a compulsory or involuntary conversion under section 1033 of the Internal Revenue Code, as incorporated in, and modified by, sections 18031 and 18031.5 of the Revenue and Taxation Code, the amount of the gain or loss from sources within this State is determined pursuant to this regulation. ~~is income from sources within this State. The gain or loss, including any gain recognized from exchanges not solely like-kind under Internal Revenue Code section 1031(b) or any gain recognized from conversions into money or property not similar or related in service or use to the converted property under Internal Revenue Code section 1033(a)(2), must be recognized upon the sale or other disposition of replacement property in a transaction in which gain or loss is recognized for federal income taxation purposes.~~

(b) *Definitions.* For purposes of this regulation,

~~(1)~~ *Deferred Gain.* "Deferred gain" ~~is means~~ means the gain that is realized upon the ~~sale or other disposition~~ exchange of real or tangible personal property but is not recognized pursuant to sections 1031 or 1033 of the Internal Revenue Code, as incorporated by section 18031 of the Revenue and Taxation Code.

~~(2)~~ *Deferred Loss.* "Deferred loss" ~~is means~~ means the loss that is realized upon the ~~sale or other disposition~~ exchange of real or tangible personal property but is not recognized pursuant to sections 1031 or 1033 of the Internal Revenue Code, as incorporated by section 18031 of the Revenue and Taxation Code.

~~(3)~~ Exchange. "Exchange" means a sale or other disposition of ~~real or tangible personal~~ property that qualifies for deferral of gain or loss pursuant to sections 1031 or 1033 of the Internal Revenue Code, as incorporated by section 18031 of the Revenue and Taxation Code.

~~(4)~~ Property. "Property" means real property.

~~(4)(5)~~ Relinquished Property. "Relinquished property" ~~is~~ means the ~~real or tangible personal~~ property that is exchanged for like-kind replacement property under section 1031 of the Internal Revenue Code or the property that is converted under section 1033 of the Internal Revenue Code, as incorporated by section 18031 of the Revenue and Taxation Code.

~~(5)(6)~~ Replacement Property. "Replacement property" means ~~real or tangible personal~~ the property acquired as like-kind property under section 1031 of the Internal Revenue Code or as property similar or related in service and use under section 1033 of the Internal Revenue Code, as incorporated by section 18031 of the Revenue and Taxation Code.

(c) ~~Single Exchange Recognition of Deferred Gain or Loss Upon the Sale of the Replacement Property.~~

~~(1) Single Exchange~~ Relinquished Property Located in this State. In a single exchange of relinquished property located in this State for replacement property located outside this State, ~~upon recognition~~ when replacement property is sold or otherwise disposed of in a transaction in which gain or loss from the exchange is recognized for federal income tax purposes, the gain or loss ~~sourced to~~ from sources within this State ~~is the lesser of either~~ shall be determined under one of the following:

A. Gain. When there is a gain recognized for federal income tax purposes and deferred gain on the exchange of the relinquished property, the amount of gain from sources within this State shall be the lesser of the deferred gain and the gain recognized for federal income tax purposes. ~~The deferred gain or deferred loss.~~

B. Loss. When there is a loss recognized for federal income tax purposes and a deferred loss on the exchange of the relinquished property, the amount of loss from sources within this State shall be the lesser of the deferred loss and the loss recognized for federal income tax purposes. ~~The gain or loss recognized for federal income tax purposes.~~

C. No Gain or Loss from Sources within this State. When there is a gain recognized for federal income tax purposes and a deferred loss on the exchange of the relinquished property, there shall be no gain or loss from sources within this State. When there is a loss recognized for federal income tax purposes and a deferred gain on the exchange of the relinquished property, there shall be no gain or loss from sources within this State.

~~(2) Single Exchange—Replacement Property Located in this State.~~ In a single exchange of relinquished property located outside this State for replacement property located in this State, when the replacement property is sold or otherwise disposed of in a transaction in which gain or loss is recognized for federal income tax purposes, the gain or loss ~~sourced to this State is the lesser of either of the following~~ for purposes of subsection (c)(2) is calculated pursuant to subsection (c)(2)(A) and the amount attributable to sources within this State is calculated pursuant to subsection (c)(2)(B):

A. Calculating the Gain or Loss. The gain or loss on the sale or other disposition of the replacement property shall be the fair market value of the replacement property at the time of its sale or other disposition, less the purchase price of that property, adjusted for:

~~4-i.~~ i. All capital expenditures, receipts, losses or other items associated with the holding of that property and properly chargeable to the capital account to the extent allowed by ~~Internal Revenue Code~~ section 1016(a)(1) of the Internal Revenue Code and the regulations thereunder, as ~~conformed to~~ incorporated by ~~California Revenue and Taxation Code~~ section 18031 of the Revenue and Taxation Code, and

~~2-ii.~~ ii. Exhaustion, wear and tear, obsolescence, amortization and depletion associated with the holding of that property under ~~Internal Revenue Code~~ section 1016(a)(2) of the Internal Revenue Code and the regulations thereunder, as ~~conformed to~~ incorporated by ~~California Revenue and Taxation Code~~ section 18031 of the Revenue and Taxation Code.

B. Gain and Loss from Sources within this State ~~The gain or loss recognized for federal income tax purposes.~~

i. Gain. When there is a gain recognized for federal income tax purposes and a gain on the sale or other disposition of the replacement property under subsection (c)(2)(A), the amount

of gain from sources within this State shall be the lesser of the gain under subsection (c)(2)(A) and the gain recognized for federal income tax purposes.

ii. Loss. When there is a loss recognized for federal income tax purposes and a loss on the sale or other disposition of the replacement property under subsection (c)(2)(A), the amount of loss from sources within this State shall be the lesser of the loss under subsection (c)(2)(A) and the loss recognized for federal income tax purposes.

iii. No Gain or Loss from Sources within this State. When there is a gain recognized for federal income tax purposes and a loss on the sale or other disposition of the replacement property under subsection (c)(2)(A), there shall be no gain or loss from sources within this State. When there is a loss recognized for federal income tax purposes and a gain on the sale or other disposition of the replacement property under subsection (c)(2)(A), there shall be no gain or loss from sources within this State.

(d) Series of Exchanges. In a series of exchanges, when replacement property is exchanged, sold, or otherwise disposed of in a transaction in which gain or loss is recognized for federal income tax purposes, including any gain recognized from exchanges not solely like-kind under section 1031(b) of the Internal Revenue Code or any gain recognized from the conversions into money or property not similar or related in service or use to the converted property under section 1033(a)(2) of the Internal Revenue Code, the gains and losses for purposes of subsection (d) are calculated pursuant to subsection (d)(1) and the amount attributable to sources within this State is calculated pursuant to subsection (d)(2).

(1) Calculating the gain or loss.

A. (1) First Relinquished Property. In a series of exchanges, the sourcing of deferred gain or deferred loss on the first relinquished property, located in or outside this State, shall be determined under subsection (c)(1)(A) as if such property were located in this State. Exchange of First Relinquished Property. The gain or loss on the exchange of the first relinquished property shall be the deferred gain or deferred loss, regardless of location.

~~(2) Subsequent Relinquished Properties. In a series of exchanges, the sourcing of deferred gain or deferred loss on subsequent relinquished properties, located in or outside this State, shall be determined under subsection (c)(2)(A) as if such properties were located in this State.~~

~~(3) Replacement Property. In a series of exchanges, the sourcing of gain or loss on the replacement property, located in or outside this State, shall be determined under subsection (c)(2)(A) as if such property were located in this State.~~

B. Exchange, Sale, or Other Disposition of Replacement Property. The gain or loss on a subsequent exchange of any replacement property or sale or other disposition of replacement property shall be calculated according to subsection (c)(2)(A), regardless of location.

~~(4) Proration Rule. After applying subsections (d)(1), (d)(2) and (d)(3), if the sum of all the deferred gain on the relinquished properties in all states, plus the gain on the replacement property, exceeds the gain recognized on the sale or other disposition of the replacement property in the transaction for federal income tax purposes, the gain sourced to this State is determined by multiplying the gain recognized for federal income tax purposes by the ratio of total deferred gain in this State and gain on the replacement property, if located in this State, over all deferred gain and gain on the replacement property.~~

(2) Gains and losses from sources within this State.

A. Gain. When there is gain recognized for federal income tax purposes and the net amount of all gains and losses calculated under subsection (d)(1) for properties located within this State results in a gain, the amount of gain from sources within this State shall be determined as follows:

- i. If the gain recognized for federal income tax purposes is greater than or equal to the sum of all gains calculated under subsection (d)(1) regardless of location, then the amount of gain from sources within this State shall be equal to the sum of all the gains calculated under subsection (d)(1) for properties located within this State.
- ii. If the gain recognized for federal income tax purposes is less than the sum of all the gains calculated under subsection

(d)(1) regardless of location, then the amount of gain from sources within this State shall be determined by multiplying the gain recognized for federal income tax purposes by the ratio of the sum of all the gains calculated under subsection (d)(1) for properties located within this State over the sum of all the gains calculated under subsection (d)(1) for all properties, regardless of location.

B. Loss. When there is a loss recognized for federal income tax purposes and the net amount of all gains and losses calculated under subsection (d)(1) for properties located within this State results in a loss, the amount of the loss from sources within this State shall be determined as follows:

- i. If the loss recognized for federal income tax purposes is greater than or equal to the sum of all losses calculated under subsection (d)(1) regardless of location, then the amount of loss from sources within this State shall be equal to the sum of all the losses calculated under subsection (d)(1) for properties located within this State.
- ii. If the loss recognized for federal income tax purposes is less than the sum of all losses calculated under subsection (d)(1) regardless of location, then the amount of loss from sources within this State shall be determined by multiplying the loss recognized for federal income tax purposes by the ratio of the sum of all losses calculated under subsection (d)(1) for properties located within this State over the sum of all losses calculated under subsection (d)(1) for all properties, regardless of location.

C. No Gain or Loss from Sources within this State. When there is a gain recognized for federal income tax purposes and the net amount of all gains and losses calculated under subsection (d)(1) for properties located in this State results in a loss, there shall be no gain or loss from sources within this State. When there is a loss recognized for federal income tax purposes and the net amount of all gains and losses calculated under subsection (d)(1)

for properties located in this State results in a gain, there shall be no gain or loss from sources within this State.

~~(5)~~(3) *Recognition Treatment.* Any ~~deferred~~ gain or ~~deferred~~ loss, once recognized, shall no longer be considered ~~deferred~~ gain or ~~deferred~~ loss for purposes of this subsection.

(e) Exchanges with Multiple Replacement Properties. When ~~relinquished~~ property is exchanged for more than one replacement property, any deferred gain and/or deferred loss under subsection (c)(1) and any gain or loss under subsection (d)(1) associated with the relinquished property exchanged shall be allocated/divided pro rata among the multiple replacement properties based on the fair market value of the replacement properties like-kind property (or property similar or related in service or use under Internal Revenue Code section 1033) received for the relinquished property. For the purposes of this subsection, the fair market value of each replacement property shall be reduced by the fair market value of any property not of like-kind or property not similar in service or use to the relinquished property used to purchase that replacement property.

~~(f)~~ *No Gain or Loss for California Income Tax Purposes.* ~~If there is a gain recognized for federal income tax purposes and a loss sourced to this State, there will be no gain or loss recognized for California income tax purposes. If there is a loss recognized for federal income tax purposes and a gain sourced to this State, there will be no gain or loss recognized for California income tax purposes.~~

~~(g)~~(f) Examples.

~~(4)~~ *Single Exchange – Relinquished Property Located in this State.* Taxpayer purchases ~~California~~ property located in this State for \$50. Taxpayer ~~exchanges~~ sells the California property located in this State for replacement property in State A with a fair market value of \$150, deferring not recognizing gain of \$100 (\$150-\$50), under Internal Revenue Code section 1031 of the Internal Revenue Code. Taxpayer ~~exchanges into~~ sells the replacement property located in State A. ~~The State A replacement property costs \$150. Taxpayer sells the State A replacement property for \$250 in a transaction in which gain of \$200 (\$250-\$50) is recognized for federal income tax purposes. Pursuant to subsection (c)(1)(A), the~~ The California recognized

gain from sources within this State is \$100, which is the lesser of the \$100 ~~California source~~ deferred gain and the \$200 gain recognized for federal income tax purposes.

~~(2) Single Exchange – Replacement Property Located in this State. Taxpayer purchases property located in State A for \$50, and sells Taxpayer exchanges the property located in State A for replacement property in this State with a fair market value of for \$120, deferring not recognizing gain of \$70 (\$120-\$50), under Internal Revenue Code section 1031 of the Internal Revenue Code. Taxpayer exchanges into replacement property located in California. The California replacement property costs \$120. Taxpayer sells the California replacement property located in this State for \$150 in a transaction in which gain of \$100 (\$150-\$50) is recognized for federal income tax purposes. The California source Pursuant to subsection (c)(2)(B), the gain from sources within this State is \$30 (\$150-\$120). The California recognized gain is \$30, which is the lesser of the \$30 California source gain calculated pursuant to subsection (c)(2)(A) (\$150-\$120) and the \$100 gain for federal income tax purposes.~~

~~(3) Series of Exchanges. Taxpayer purchases California property for \$50. Taxpayer sells the California property for \$150, deferring gain of \$100 (\$150-\$50), under Internal Revenue Code section 1031. Taxpayer exchanges into replacement property located in State A. The replacement property in State A costs \$150. Taxpayer sells the replacement property in State A for \$300, deferring the State A source gain of \$150 (\$300-\$150) and continuing to defer the \$100 of California gain, under Internal Revenue Code section 1031. Taxpayer exchanges into replacement property located in State B. The replacement property in State B costs \$300. Taxpayer sells the replacement property in State B for \$170 in a transaction in which gain of \$120 is recognized for federal income tax purposes.~~

~~The proration rule in subsection (d)(4) applies since the total of the California deferred gain and California gain (\$100) plus the deferred gain and gain in other states (\$150) exceeds the gain recognized for federal income tax purposes (\$120). The gain to be recognized for California income tax purposes is \$48, which is the gain recognized for federal income tax purposes (\$120) multiplied by the ratio of California deferred gain and California gain (\$100) over the deferred gain and gain in all states (\$250). The loss in State B is not considered.~~

Series of Exchanges. Taxpayer purchases property located in this State for \$50. Taxpayer exchanges property located in this State for replacement

property located in State A with a fair market value of \$150, not recognizing gain of \$100 (\$150-\$50) under section 1031 of the Internal Revenue Code. Taxpayer exchanges property in State A for replacement property located in State B with a fair market value of \$300, not recognizing gain of \$150 (\$300-\$150) and continuing to not recognize the gain of \$100 under section 1031 of the Internal Revenue Code. Taxpayer sells the replacement property located in State B for \$170 in a transaction in which gain of \$120 (\$170-\$50) is recognized for federal income tax purposes.

Pursuant to subsection (d)(1)(A), the gain on the sale of property located in this State is \$100 (\$150-\$50). Pursuant to subsection (d)(1)(B), the gain on the sale of property located in State A is \$150 (\$300-\$150), and the loss on the sale of property located in State B is \$130 (\$170-\$300).

Pursuant to subsection (d)(2)(A), there is gain recognized for federal income tax purposes (\$120) and a net amount of gain on the property located in this State (\$100). The gain recognized for federal income tax purposes (\$120) is less than the sum of all the gains regardless of location (\$250 [\$100+\$150]) calculated under subsection (d)(1). Therefore, the gain from sources within this State is determined under subsection (d)(2)(A)(ii). The amount of gain from sources within this State is \$48, which is determined by multiplying the federal gain (\$120) by the ratio of the gain on the property located in this State (\$100) over the sum of all gains regardless of location (\$250).

~~(4) Series of Exchanges — Not solely Like-Kind. Taxpayer purchases California property for \$50. Taxpayer sells the California property for \$150, deferring gain of \$100 (\$150-\$50), under Internal Revenue Code section 1031. Taxpayer exchanges into replacement property located in State A. The replacement property in State A costs \$150. Taxpayer sells the replacement property in State A for \$300, deferring the State A source gain of \$150 (\$300-\$150) and continuing to defer the \$100 of California gain, under Internal Revenue Code section 1031. Taxpayer exchanges into replacement property located in State B. The replacement property in State B costs \$275 and Taxpayer takes out \$25 cash. Taxpayer sells the replacement property in State B for \$250 in a transaction in which gain of \$200 is recognized for federal income tax purposes.~~

~~The receipt of \$25 is recognized immediately upon the exchange of the State A property under Internal Revenue Code 1031.~~

~~The proration rule in subsection (d)(4) applies since the total of the California deferred gain and California gain (\$100) plus the deferred gain and gain in~~

~~other states already part of the exchange (\$150) exceeds the gain recognized for federal income tax purposes (\$25). The gain to be recognized for California income tax purposes is \$10, which is the gain recognized for federal income tax purposes (\$25) multiplied by the ratio of California deferred gain and California gain (\$100) over the deferred gain and gain in all states thus far in the exchange (\$250). The future exchange or sale in State B is not considered. Under the recognition treatment rule in subsection (d)(5), the \$25 recognized is no longer considered deferred gain or deferred loss for purposes of this subsection.~~

Series of Exchanges – Not Solely Like-Kind. Taxpayer purchases property located in this State for \$50. Taxpayer exchanges property located in this State for replacement property located in State A with a fair market value of \$150, not recognizing gain of \$100 (\$150-\$50) under section 1031 of the Internal Revenue Code. Taxpayer exchanges property located in State A for replacement property located in State B with a fair market value of \$275 and receives \$25 cash, not recognizing gain of \$125 (\$275-\$150) and continuing to not recognize the gain of \$100 under section 1031 of the Internal Revenue Code. The receipt of \$25 cash is recognized immediately for federal income tax purposes upon the exchange of property in State A under section 1031(b) of the Internal Revenue Code.

Pursuant to subsection (d)(1)(A), the gain on the sale of property located in this State is \$100 (\$150-\$50). Pursuant to subsection (d)(1)(B), the gain on the sale of property located in State A is \$150 (\$300-\$150).

Pursuant to subsection (d)(2)(A) there is a gain recognized for federal income tax purposes (\$25) and a net amount of gain on the property located in this State (\$100). The gain recognized for federal income tax purposes (\$25) is less than the sum of all the gains regardless of location (\$250 [\$100+\$150]) under subsection (d)(1). Therefore, the gain from sources within this State is determined under subsection (d)(2)(A)(ii). The amount of gain from sources within this State is \$10, which is determined by multiplying the federal gain (\$25) by the ratio of the gain on the property located in this State (\$100) over the sum of all gains regardless of location (\$250).

Pursuant to subsection (d)(3), the \$10 of gain recognized in this State is no longer considered gain or loss under subsection (d). The gain on the property within this State is now \$90 (\$100-\$10).

~~(5) Multiple Replacement Properties.~~ Taxpayer purchases California property for \$210. Taxpayer sells the property for \$300, deferring gain of \$90 (\$300-

~~\$210), under Internal Revenue Code section 1031. Taxpayer exchanges into replacement property X located in State A and replacement property Y located in State B. The fair market value of replacement property X and replacement property Y is \$200 each. In the exchange transaction, \$200 from the relinquished property is used to exchange for replacement property X, and \$100 from the relinquished property plus \$100 of additional cash is used to exchange for replacement property Y. The California source deferred gain is allocated \$60 to replacement property X ($\$90 \times (\$200/\$300)$) and \$30 to replacement property Y ($\$90 \times (\$100/\$300)$).~~

Multiple Replacement Properties. Taxpayer purchases property located in this State for \$210. Taxpayer exchanges property located in this State and \$100 cash for replacement properties in State X and State Y with a fair market value of \$200 each, not recognizing gain of \$90 ($[\$400 - \$100] - \210) under section 1031 of the Internal Revenue Code. Replacement property located in State X is acquired using \$200 from the relinquished property. Replacement property located in State Y is acquired using the remaining \$100 from the relinquished property and \$100 of cash.

Replacement property located in State Y was acquired using \$100 cash. Therefore, under subsection (e), its fair market value (\$200) is reduced by the not like-kind property (cash of \$100) when dividing the deferred gain from the relinquished property located in this State among the multiple replacement properties. The deferred gain from property located in this State is divided \$60 to replacement property located in State X ($\$90 \times (\$200/\$300)$) and \$30 to replacement property located in State Y ($\$90 \times ([\$200 - \$100]/\$300)$).

~~(6) *No Gain or Loss for California Income Tax Purposes.* Taxpayer purchases California property for \$250. Taxpayer sells the California property for \$320, deferring gain of \$70 ($\$320 - \250), under Internal Revenue Code section 1031. Taxpayer exchanges into replacement property located in State A. The State A replacement property costs \$320. Taxpayer sells the State A replacement property for \$200 in a transaction in which a loss of \$50 is recognized for federal income tax purposes. The California recognized gain/loss is \$0 because there is a gain for California purposes and a loss for federal income tax purposes.~~

No Gain or Loss from Sources within this State. Taxpayer purchases property located in this State for \$250. Taxpayer exchanges property located in this State for replacement property located in State A with a fair market

value of \$320, not recognizing gain of \$70 (\$320-\$250) under section 1031 of the Internal Revenue Code. Taxpayer sells property located in State A for \$200 in a transaction in which a loss of \$50 (\$200-\$250) is recognized for federal income tax purposes. Pursuant to subsection (c)(1)(C), there is no gain or loss from sources within this State because there is a loss recognized for federal income tax purposes and a deferred gain under subsection (c)(1)(A).

NOTE: Authority: Revenue and Taxation Code section 17954. Reference: Revenue and Taxation Code section 18031.