TAXABLE YEAR | CALIFORNIA FORM

2009 Investment Interest Expense Deduction 3526

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

Name(s) as shown on return | SSN, ITIN, or FEIN

1	Investment interest expense paid or accrued in 2009. See instructions	1	00
2	Disallowed investment interest expense from 2008 form FTB 3526, line 7. If zero or less, enter -0-	2	00
3	Total investment interest expense. Add line 1 and line 2.	3	00
4a	Gross income from property held for investment (excluding any net gain from the disposition of property held for investment). See instructions	4a	00
4b	Net gain from the disposition of property held for investment. See instructions 4b 00		
4c	Net capital gain from the disposition of property held for investment. See instructions 4c 00		
4d	Subtract line 4c from line 4b. If zero or less, enter -0-	4d	00
4e	Enter all or part of the amount on line 4c that you elect to include in investment income. **Do not** include more than the amount on line 4b. See instructions	4e	00
4f	Investment income. Add line 4a, line 4d, and line 4e	4f	00
5	Investment expenses. See instructions	5	00
6	Net investment income. Subtract line 5 from line 4f.	6	00
7	Disallowed investment interest expense to be carried forward to 2010. Subtract line 6 from line 3. If zero or less, enter -0-	7	00
8	Investment interest expense deduction. Enter the smaller of line 3 or line 6. Form 541 filers, stop here and see instructions. All other filers, go to line 9	8	00
9	Enter the amount from federal Form 4952, line 8	9	00
10	California investment interest expense deduction adjustment. Enter the difference between line 8 and line 9. See instructions.	10	00

General Information

In general, California law conforms to the Internal Revenue Code (IRC) as of January 2005. However, there are continuing differences between California and federal law. When California conforms to federal tax law changes, we do not always adopt all of the changes made at the federal level. For more information, go to **ftb.ca.gov** and search for **conformity**. Additional information can be found in FTB Pub. 1001, Supplemental Guidelines to California Adjustments, the instructions for California Schedule CA (540 or 540NR), California Adjustments, and the Business Entity tax booklets.

The instructions provided with California tax forms are a summary of California tax law and are only intended to aid taxpayers in preparing their state income tax returns. We include information that is most useful to the greatest number of taxpayers in the limited space available. It is not possible to include all requirements of the California Revenue and Taxation Code (R&TC) in the tax booklets. Taxpayers should not consider the tax booklets as authoritative law.

Net capital gain from the disposition of property held for investment is excluded from investment income when figuring the investment interest limitation. However, taxpayers may elect to include in their investment income as much of their net capital gain investment income as they choose, if they also reduce the amount of net capital gain eligible for the special federal capital gain tax rate.

This form allows you to make a separate California election to include net capital gain investment income in the calculation of the investment interest limitation. However, California taxes all income at the same rate. Consider the effect on your California tax before making a separate California election or applying the federal election for California purposes.

Registered Domestic Partners (RDP)

RDPs under California law must file their California income tax return using either the married/RDP filing jointly or married/RDP filing separately filing status. RDPs have the same legal benefits, protections, and responsibilities as married couples unless otherwise specified.

For purposes of California income tax, references to a spouse, husband, or wife also refer to a California registered domestic partner (RDP), unless otherwise specified. When we use the initials RDP they refer to both a California registered domestic "partner" and a California registered domestic "partnership," as applicable. For more information on RDPs, get FTB Pub. 737, Tax Information for Registered Domestic Partners.

Round Cents to Dollars – Round cents to the nearest whole dollar. For example, round $50.50 up to $51 or round $25.49 down to $25.

Military Personnel – Servicemembers domiciled outside of California, and their spouses/RDP, may exclude the member's military compensation from gross income when computing the tax rate on nonmilitary income. Requirements for military servicemembers domiciled in California remain unchanged. Military servicemembers domiciled in California must include their military pay in total income. In addition, they must include their military pay in California source income when stationed in California. However, military pay is not California source income when a servicemember is permanently stationed outside of California. Beginning in 2009, the Military Spouses Residency Relief Act may affect the California income tax filing requirements for spouses of military personnel. For more information, get FTB Pub. 1032, Tax Information for Military Personnel.

A Purpose

Use form FTB 3526, Investment Interest Expense Deduction, to figure the amount of investment interest expense deductible for the current year and the amount, if any, to carry forward to future years. Interest expense paid by an individual, estate, or trust on a loan allocable to property held for investment may not be fully deductible in the current year.

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.

Exception: You do not have to file form FTB 3526 if **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.
- You have no disallowed investment interest expense from 2008.

Specific Line 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 Publication 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 taxable year, regardless of when you incurred the indebtedness. Investment interest expense is interest paid or accrued on a loan (or part of a loan) that is allocable to property held for investment.

Include investment interest expense reported to you on Schedules K-1 (100S, 541, 565, or 568), Share of Income, Deductions, Credits, etc. 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:

- Qualified residence interest.
- Interest expense that is properly allocable to a passive activity (see "Passive Activities" below).
- Interest expense that is capitalized, such as construction interest subject to IRC Section 263A.
- Interest expense related to tax-exempt interest income under R&TC Section 17280.

Property Held for Investment. Property held for investment includes property that produces investment income (unless derived in the ordinary course of a trade or business). It also includes property that produces gain or loss, **not** derived in the ordinary course of a trade or business, from the disposition of property that produces these types of income or is held for investment.

However, it does not include an interest in a passive activity (see "Passive Activities" below).

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 that is not a passive activity is property held for investment if you did not materially participate in the activity.

Passive Activities. Generally, a passive activity is any business activity in which you do not materially participate and any rental activity regardless of your level of participation. Investment interest expense does not include any interest expense that is included when 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 included 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 federal purposes only, rental real estate activities conducted by persons in a real property business are not automatically treated as passive activities. California does not conform to this provision. For more information about passive activities, get the instructions for federal Schedule E (Form 1040), Supplemental Income and Loss.

Line 4a – Gross Income from Property Held for Investment

Enter your gross income from property held for investment. This includes income (not derived in the ordinary course of a trade or business) from interest, dividends, annuities, and royalties. Net income from the following passive activities is also treated as investment income:

- Rental of substantially nondepreciable property.
- Equity-financed lending activities.
- Acquisition of certain interests in a pass-through entity licensing intangible property.

Also include on line 4a (or line 4b, if applicable) net passive income from a passive activity of a publicly traded partnership, as defined in IRC Section 469(k)(2), investment income reported to you on Schedules K-1 (100S, 541, 565, or 568), and net investment income from an estate or trust.

Line 4b

Enter your net gain from the disposition of property held for investment. This is the excess of total gains over total losses from the disposition of property held for investment. When figuring this amount, include capital gain distributions from mutual funds.

Line 4c

Enter your net capital gain from the disposition of property held for investment. This is the excess of your net long-term capital gain over net short-term capital loss from the disposition of property held for investment. Capital gain distributions from mutual funds are treated as long-term capital gains.

Line 4e

Net capital gain from the disposition of property held for investment, line 4c, is excluded from investment income. However, you may elect to include in investment income all or part of the net capital gain from the disposition of property held for investment. Make the election no later than the due date (including extensions) of your California income tax return. Once made, the election may not be revoked without the consent of the Franchise Tax Board.

To make the election, enter all or part of the amount on line 4c, but not more than the amount on line 4b, that you elect to include in investment income.

Line 5 – Investment Expenses

If you are a military servicemember domiciled outside of California, subtract your military pay from your federal adjusted gross income.

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.

Include investment expenses reported to you on Schedules K-1 (100S, 541, 565, or 568).

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 23, the two percent adjusted gross income limitation on federal Schedule A (Form 1040), line 26, may reduce the amount you include on form FTB 3526, line 5.

Include on form FTB 3526, line 5, the smaller of either the investment expenses included on federal Schedule A (Form 1040), line 23 or the total federal Schedule A (Form 1040), line 27.

If you made adjustments to your miscellaneous expenses on Schedule CA (540 or 540NR), be sure to include the adjustments in the calculation.

If you reported investment expenses on a form or schedule other than federal Schedule A (Form 1040), include those expenses when figuring investment expenses for line 5.

Line 8 – Investment Interest Expense Deduction

Form 541, California Fiduciary Income Tax Return, filers should enter the amount from line 8 on Form 541, line 10. All other filers must complete line 9.

At-Risk Activities. If any portion of the deductible investment interest expense on line 8 is attributable to an activity for which you are not at risk, complete federal Form 6198, At-Risk Limitations, (using California amounts) to figure your deductible investment interest expense.

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 8 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 10 – California Investment Interest Expense Deduction Adjustment

The amount on line 10 is the difference between the deduction allowed by California and federal law.

If line 8 is more than line 9, subtract line 9 from line 8. Enter the result as a positive amount on line 10 and on Schedule CA (540 or 540NR), line 41. Be sure to write "FTB 3526" on Schedule CA (540 or 540NR), line 41.

If line 9 is more than line 8, subtract line 8 from line 9. Enter the result as a negative amount on line 10 and on Schedule CA (540 or 540NR), line 41. Write "FTB 3526" on Schedule CA (540 or 540NR), line 41.

If any portion of your investment interest expense on line 8 is attributable to royalties, enter the difference between the California and federal amounts on Schedule CA (540 or 540NR), line 17, column B or column C, as appropriate.

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