INTERESTED PARTIES
MEETING
1031 EXCHANGE SOURCING REGULATION

February 3, 2016
NOTE: This handout is intended only for purposes of facilitating discussion at the interested parties meeting on February 3, 2016 – it illustrates the various scenarios that FTB staff will be referring to during our discussion.

1. Exchange out of California – Appreciation in Value

Buy for $5  Exchange at $10
Year 1: California

Year 2:
$10 State A

$5 California Appreciation  $10 State A Appreciation

$15 Federal Gain

• How much of the $15 federal gain ($20 sales price minus $5 basis) is California source gain?
2. Exchange out of California – Depreciation in Value

Buy for $5
Exchange at $10

Year 1:
California
Sell at $8
$10

Year 2:
State A

$3 Federal Gain - $2 State A Depreciation

$5 California Appreciation

• How much of the $3 federal gain ($8 sales price minus $5 basis) is California source gain?
• Does TP have California source gain in excess of the federal gain reported in the year the State A property is sold?
3. Exchange out of California – Loss on Sale

Year 1:

Buy for $5

Exchange at $10

California

Year 2:

Sell at $4

State A

$10

-$1 Federal Loss

$5 California Appreciation

-$6 State A Depreciation

• How much of the $1 federal loss ($4 sales prices minus $5 basis) is California source loss?
• Does TP have California source gain in the year State A property is sold even though a federal loss is reported?
4. Exchange into California – Appreciation in Value

Year 1:
- Buy for $5
- Exchange at $10
- State A

Year 2:
- Sell at $20
- California

$5 State A Appreciation

$10 California Appreciation

$15 Federal Gain

• How much of the $15 federal gain ($20 sales price minus $5 basis) is California source gain?
5. Exchange into California – Depreciation in Value

Buy for $5

Year 1:

Sell at $8

State A

Exchange at $10

Year 2:

Sell at $8

California

$3 Federal Gain - $2 California Depreciation

$5 State A Appreciation

• How much of the $3 federal gain ($8 sales price minus $5 basis) is California source gain?

• Does TP have a California source loss even though TP is reporting a federal gain in the year the California replacement property is sold?
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**6. Exchange into California – Loss on Sale**

<table>
<thead>
<tr>
<th>Year 1:</th>
<th>Year 2:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Buy for</strong></td>
<td><strong>Exchange at</strong></td>
</tr>
<tr>
<td>$5</td>
<td>$10</td>
</tr>
<tr>
<td><strong>State A</strong></td>
<td><strong>California</strong></td>
</tr>
<tr>
<td><strong>Sell at</strong></td>
<td><strong>$10</strong></td>
</tr>
<tr>
<td>$4</td>
<td></td>
</tr>
</tbody>
</table>

- **Federal Loss**
- **State A Appreciation**
- **California Depreciation**

- $1 Federal Loss
- $5 State A Appreciation
- $6 California Depreciation

- How much of the $1 federal loss ($4 sales prices minus $5 basis) is California source loss?
- Does TP have California source loss in excess of the federal loss in the year the California replacement property is sold?
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7. Multiple Exchanges – Insufficient Deferred Gain

- How much of the $3 federal gain ($8 sales prices minus $5 basis) is California source gain?
- Does TP have California source gain in excess of the federal gain reported in the year the State C property is sold?
7. Multiple Exchanges – Insufficient Deferred Gain - Cont’d

New Fact: The State C property is sold for $15 instead of $8.

- How much of the $10 federal gain ($15 sales price minus $5 basis) is California source gain?
8. Multiple Exchanges – Loss on Sale

Year 1:
Buy for $5
Exchange at $10
California

Year 2:
Exchange at $15
State A

Year 3:
Sell at $4

Year 4:
State C
-$1 Federal Loss $5 California Appreciation $5 State A Appreciation $5 State B Appreciation

-$16 State C Depreciation

- How much of the $1 federal loss ($4 sales prices minus $5 basis) is California source loss?
- Does TP have California source gain in the year the State C property is sold even though a federal loss is reported?
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9. Exchange into & back out of California – Depreciation in Value

<table>
<thead>
<tr>
<th>Year 1: Buy for $5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchange at $10</td>
</tr>
<tr>
<td>State A</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year 2:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sell at $10</td>
</tr>
<tr>
<td>California</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year 3:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchange at $20</td>
</tr>
<tr>
<td>State B</td>
</tr>
</tbody>
</table>

- $5 State A Appreciation
- $10 California Appreciation
- $5 Federal Gain
- -$10 State B Depreciation

- How much of the $5 federal gain ($10 sales prices minus $5 basis is California source gain? 
- Does TP have California source gain in excess of the federal gain reported in the year the State B property is sold?
9. Exchange into & back out of California – Depreciation in Value – Cont’d

New Fact: The State B property is sold for $15 instead of $10.

- $10 Federal Gain
- $5 State A Appreciation
- $10 California Appreciation
- $5 State B Depreciation

How much of the $10 federal gain ($15 sales price minus $5 basis) is California source gain?
10. Exchange into & back out of California – Loss on Sale

Year 1:
- Buy for $5
- Exchange at $10
  - State A

Year 2:
- Sell at $4
  - California

Year 3:
- Exchange at $20
  - State B

- $1 Federal Loss
- $5 State A Appreciation
- $10 California Appreciation
- $16 State B Depreciation

- How much of the $1 federal loss ($4 sales price minus $5 basis is California source loss?
- Does TP have California source gain in the year the State B property is sold even though a federal loss is reported?
11. Exchange into & back out of California – California Depreciation in Value

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
<th>State A</th>
<th>State B</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Buy for $5</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Exchange at $10</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Exchange at $8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Sell at $20</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>$5 State A Appreciation</td>
<td>$12 State B Appreciation</td>
<td></td>
</tr>
<tr>
<td></td>
<td>-$2 California Depreciation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$15 Federal Gain</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- How much of the $1 federal loss ($4 sales price minus $5 basis is California source loss?)
- Does TP have California source gain in the year the State B property is sold even though a federal loss is reported?
12. Exchange into & back out of California – California Depreciation in Value & Loss on Sale

Year 1:
- State A: Exchange at $15
- California: Exchange at $8

Year 2:
- State B: Sell at $4

Year 3:
- State B: $8

$1 Federal Loss
$10 State A Appreciation
-$4 State B Depreciation
-$7 California Depreciation

- How much of the $1 federal loss ($4 sales price minus $5 basis) is California source loss?
- Does TP have California source gain in the year the State B property is sold even though a federal loss is reported?
13. Apportioning Taxpayers

- Is a regulation necessary to clarify which year’s apportionment rules and percentages should be applied to deferred gains/losses from 1031 exchanges?

- Scope of the Regulation?
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14. Other Issues?