17951-7. Deferred gains and losses from exchanges of real or tangible property in this state

(a) *In General.* Gain or loss realized 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, as incorporated in, and modified by, sections 18031 and 18031.5 of the Revenue and Taxation Code, 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 the gain that is realized upon the sale or other disposition of real or tangible personal property but is not recognized pursuant to section 1031 or 1033 of the Internal Revenue Code.

(2) *Deferred Loss*. "Deferred loss" is the loss that is realized upon the sale or other disposition of real or tangible personal property but is not recognized pursuant to section 1031 or 1033 of the Internal Revenue 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 section 1031 or 1033 of the Internal Revenue Code.

(4) *Relinquished Property.* "Relinquished property" is the real or tangible personal property that is exchanged for replacement property.

(5) *Replacement Property*. "Replacement property" means real or tangible personal 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.

(c) *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 of gain or loss from the exchange for federal income tax purposes, the gain or loss sourced to this State is the lesser of either of the following:

A. The deferred gain or deferred loss.

B. The gain or loss recognized for federal income tax purposes.

(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:

A. 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:

1. 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 IRC section 1016(a)(1) and the regulations thereunder, as conformed to by CRTC section 18031, and

2. Exhaustion, wear and tear, obsolescence, amortization and depletion associated with the holding of that property under IRC section 1016(a)(2) and the regulations thereunder, as conformed to by CRTC section 18031.

B. The gain or loss recognized for federal income tax purposes.

(d) *Series of Exchanges*.

(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.

(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.

(4) 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.

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

(e) *Multiple Replacement Properties*. When relinquished property is exchanged for more than one replacement property, deferred gain and deferred loss associated with the relinquished property shall be allocated pro rata among the multiple replacement properties based on the fair market value of like-kind property (or property similar or related in service or use under IRC section 1033) received for the relinquished 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) *Examples*.

(1) *Single Exchange – Relinquished Property Located in this State*. Taxpayer purchases California property for $50. Taxpayer sells the California property for $150, deferring gain of $100 ($150-$50), under IRC section 1031. Taxpayer exchanges into 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 is recognized for federal income tax purposes. The California recognized gain 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 in State A for $50 and sells the property for $120, deferring gain of $70 ($120-$50), under IRC section 1031. Taxpayer exchanges into replacement property located in California. The California replacement property costs $120. Taxpayer sells the California replacement property for $150 in a transaction in which gain of $100 is recognized for federal income tax purposes. The California source gain is $30 ($150-$120). The California recognized gain is $30, which is the lesser of the $30 California source gain 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 IRC 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 IRC 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.

(4) *Multiple Replacement Properties*. Taxpayer purchases California property for $210. Taxpayer sells the property for $300, deferring gain of $90 ($300-$210), under IRC section 1031. Taxpayer exchanges into replacement property X located in State A and replacement property Y located in State B. Replacement property X is exchanged into using $200 from the relinquished property. Replacement property Y is exchanged into using $100 from the relinquished property plus $100 of additional cash. The California source deferred gain is allocated $60 to replacement property X ($90 x ($200/$300)) and $30 to replacement property Y ($90 x ($100/$300)).

(5) *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 IRC 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.

NOTE: Authority: Revenue and Taxation Code section 17954. Reference: Revenue and Taxation Code sections 18031 and 18031.5; Title 26 U.S.C. sections 1031, 1033 and 1016.