STATE OF CALIFORNIA
FRANCHISE TAX BOARD

FTB Publication 1005

Pension and Annuity Guidelines

INTERNET ASSISTANCE

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- Getting a Customer Service Number and other tips for e-filing your tax return
- Finding out if you can TeleFile
- Checking the status of your refund and account balance inquiry
- Learning about new and more convenient methods for paying your tax
- Downloading tax forms and publications – sorted by year and by form number
- Viewing internal procedure manuals to learn how we administer the law
- Accessing legal notices, rulings, regulations; see FTB's analysis of pending legislation; and get current law/policy information by reading Tax News Online

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General Information

California law now conforms to certain provisions of the Internal Revenue Code (IRC) related to pension plans and deferred compensation, as those provisions apply for federal purposes including amendments to the IRC that may be enacted in the future.

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.

Caution: If you have an Individual Retirement Arrangement (IRA) basis and were a nonresident in prior years, you may need to restate your California IRA basis. See "2002 Law Changes IRA Basis of Former Nonresidents" on page 5.

Maximum Contribution Amounts to Traditional and Roth IRAs. Effective January 1, 2002, taxpayers may contribute the following maximum amounts to a traditional and/or Roth IRA:

Age	2002	2003	2004	2005	2006	2007
Under 50	$3,000	$3,000	$3,000	$4,000	$4,000	$4,000
50 & Over	$3,500	$3,500	$3,500	$4,500	$5,000	$5,000

Maximum Contribution Amounts to 401(K), 403(B), and 457 Plans. Effective January 1, 2002, taxpayers may contribute the following amounts to a deferred compensation plan:

Age	2002	2003	2004	2005	2006	2007
Under 50	$11,000	$12,000	$13,000	$14,000	$15,000	$15,000
50 & Over	$12,000	$14,000	$16,000	$18,000	$20,000	$20,000

Maximum Contribution Amounts to Savings Incentive Match Plan for Employees (SIMPLE). Effective January 1, 2002, taxpayers may contribute the following amounts to a Simple IRA and Simple 401(K).

Age	2002	2003	2004	2005	2006	2007
Under 50	$7,000	$8,000	$9,000	$10,000	$10,000	$10,000
50 & Over	$7,500	$9,000	$10,500	$12,000	$12,500	$12,500

Maximum Contribution Amounts to KEOGH. Effective January 1, 2002, the maximum contribution amount a taxpayer can make to a KEOGH plan is increased from $35,000 to $40,000.

Maximum Deduction and Contribution Amounts to a Simplified Employee Pension (SEP). For plan years beginning after 2001 through 2003, the maximum deduction and contribution amount to a SEP increased to the lesser of $40,000 or 25% of compensation (compensation is limited to $200,000).

Rollovers. Section 457 plans can be rolled over to other qualified plans. In addition, distributions from a Section 457 plan can be used to purchase permissive service credit for other retirement plans.

A surviving spouse can roll over distributions from a deceased spouse's qualified retirement plan to a Section 457 plan in which the surviving spouse participates.

Introduction

This publication provides information on the California tax treatment of the distributions you receive from your pension plans, annuity plans, or IRAs, and how to report these amounts on your California income tax return.

The California treatment of pensions, annuities, and IRAs is generally the same as the federal treatment of such income. However, there are some differences between California law and federal law that may cause the amount of your California distribution income to be different than the amount reported for federal purposes. This publication will identify the most common differences and explain how to report these differences on your California return.

Important Reminders

Nonresidents of California. California does not impose tax on retirement income received by a nonresident after 12/31/95.

California generally conforms to federal law. The California treatment of pension and annuity income is generally the same as the federal treatment. For example, California and federal law are the same regarding:

- The “General Rule;”
- The “Simplified General Rule” (sometimes called the “Safe Harbor Method”);
- IRA Rollovers;
- Roth IRAs;
- Coverdell Education Savings Accounts [ESAs];
- Archer Medical Savings Accounts (MSAs);
- Current-year IRA deductions; and
- The lump-sum credit received by federal employees.

Differences between California and federal law. There are differences between California and federal law for:

- Social security and railroad retirement benefits;
- Retirees using the “Three-Year Rule” whose annuity starting date was after 7/1/86 and before 1/1/87; and
- Some prior-year IRA deductions.

Pensions invested in U.S. Government Securities. If your pension plan invested in U.S. Government securities or in mutual funds that invested in U.S. Government securities, you may not reduce the taxable portion of your pension distribution by the amount of interest attributable to the U.S. Government securities.

Common Terms Used in this Publication

AGI	Adjusted Gross Income
California Adjustment	An adjustment to your federal adjusted gross income (an addition or subtraction) to arrive at your California amount
Form 540	California Resident Income Tax Return
Form 540A	California Resident Income Tax Return
Long Form 540NR	California Nonresident or Part-Year Resident Income Tax Return
Schedule CA (540)	California Adjustments — Residents
Schedule CA (540NR)	California Adjustments — Nonresidents or Part-Year Residents
Traditional IRA	A traditional IRA is any IRA that is not a Roth IRA or SIMPLE IRA

Figuring Your California Pension, Annuity, and IRA Amounts

You must first complete your federal return before starting your California return. If you need information on how to report your pension, annuity, or IRA income on your federal return, refer to federal forms, instructions, and publications.

Once you have completed your federal return, compute the California amounts of your pension, annuity, or IRA income. If the California amount is different than the federal amount, you will need to make a California adjustment.* Depending on the California form you file, report your California adjustment on:

- Schedule CA (540) for Form 540 filers;
- Schedule CA (540NR) for Long Form 540NR filers; and
- Form 540A, Side 1, Step 4, for Form 540A filers.

*A California adjustment is an addition to or subtraction from your federal AGI. Your federal pension, annuity, or IRA income is included in the federal AGI figure that you list on your California return (Form 540, line 13; Long Form 540NR, line 13; or Form 540A, line 12b).

Social Security and Railroad Retirement Benefits

California law differs from federal law in that California does not tax:

- Social security benefits;
- Social security equivalent benefit (SSEB) portion of tier 1 railroad retirement benefits;
- Non-SSEB portion of tier 1 railroad retirement benefits;
- Tier 2 railroad retirement benefits reported on federal Form RRB 1099-R; and**
- Sick pay benefits under the Railroad Unemployment Insurance Act.

You must make an adjustment to exclude any of this income if it was included in your federal AGI. See the instructions for Schedule CA (540 or 540NR), line 7, line 16, and line 20b, or Form 540A, Side 1, Step 4, for more information.

Note: The information above applies only to United States social security and railroad retirement. Foreign social security is taxable by California as annuity income. A tax treaty between the United States and another country which excludes the foreign social security from federal income or which treats the foreign social security as if it were United States social security does not apply for California purposes.

** Railroad benefits paid by individual railroads **are** taxable by California. These benefits are reported on federal Form 1099-R.

Three-Year Rule

The "Three-Year Rule" was repealed for retirees whose annuity starting date is after 12/31/86. However, if your annuity starting date was before 1/1/87, and you elected to use the "Three-Year Rule," you must continue to use this method.

Under the "Three-Year Rule," amounts you receive are not taxed until your after-tax contributions are recovered. Once your contributions are recovered, your pension or annuity is fully taxable.

Generally, the California and federal taxable amounts are the same and you should not make an adjustment to your federal AGI. However, if your annuity starting date was after 7/1/86, and before 1/1/87, **AND** you elected to use the three-year recovery rule for California, you must make an adjustment to your federal AGI. Compute the adjustment by subtracting the federal taxable amount from the California taxable amount.

Form 540 or Long Form 540NR Filers. Enter the difference on Schedule CA (540 or 540NR), line 16b, column C.

Form 540A Filers. Enter the difference in parentheses on Form 540A, Side 1, Step 4, line 13f and follow the instructions for Form 540A.

California Residents Receiving an Out-of-State Pension

In General

California residents are taxed on ALL income, including income from sources outside California. Therefore, a pension attributable to services performed outside California but received after you became a California resident is taxable in its entirety by California. See Examples 1 through 4.

Examples:

Example 1 – You worked 10 years in Texas, moved to California and worked an additional 5 years for the same company. You retired in California and began receiving your pension, which is attributable to your services performed in both California and Texas. The taxable amount of your pension for federal purposes is $10,000.

Determination: You are a full-year resident of California. As a California resident, you are taxed on all your income, regardless of its source. Therefore, the amount taxable for California purposes is $10,000, even though a portion of the pension is for the services you performed in Texas. **Do not** make an adjustment on Schedule CA (540), or Form 540A, Side 1, Step 4, to exclude any of the pension from your income.

Example 2 – You worked in New York for 20 years. You retired and moved permanently to California on January 1. While living in California, you begin receiving your pension attributable to the services performed in New York.

Determination: You are a full-year resident of California. As a California resident, you are taxed on all your income, regardless of its source. Therefore, your pension is taxable by California, even though the pension has a New York source. **Do not** make an adjustment on Schedule CA (540), or Form 540A, Side 1, Step 4, to exclude any of the pension from your income.

Example 3 – In December 2002, you retired and moved permanently to California. Prior to your move, you elected to receive your pension as a lump-sum distribution. Your pension is attributable solely to services you performed in Washington prior to your move. You received the lump-sum distribution in February 2003, after you became a California resident. The taxable amount of the lump-sum distribution for federal purposes is $80,000.

Determination: You are a full-year California resident in 2003. As a California resident, you are taxed on all income, regardless of its source. Although the lump-sum distribution is attributable to services you performed in Washington, the full $80,000 is taxable by California because you were a resident when you received the distribution.

Example 4 – You worked in Georgia for 20 years. You retired and began receiving your monthly pension on January 1, 2003, while you were still living in Georgia. Your pension is $2,000 a month. Because you did not contribute to the plan, your pension is fully taxable. On May 1, 2003, you moved permanently to California.

Determination: You are a part-year resident of California. While you are a nonresident, only your California-source income is taxable by California. While you are a resident, all of your income, regardless of its source, is taxable by California. Because your pension is attributable to services you performed in Georgia, your pension has a Georgia source. None of the pension received while you were a nonresident of California is taxable by California. However, the pension received during the period that you are a California resident (May 1 through December 31) is taxable by California. Therefore, $16,000 ($2,000 x 8 months) is the taxable portion of the pension to enter on Schedule CA (540NR), line 16b, column E. **Do not** make an adjustment on Schedule CA (540NR), column B, to exclude any portion of the Georgia pension from total income.

Military Pension

If you are a California resident, your military pension is taxable by California, regardless of where the service was performed. See Example 5.

Example 5 – You are a California resident receiving your military pension. You served 20 years in the military. You were never stationed in California during your military career. Your military pension included in federal AGI is $30,000.

Determination: Your military pension of $30,000 is taxable by California even though your pension does not have a California source. As a California resident, you are taxed on all income from all sources.

Nonresidents of California Receiving a California Pension

In General

California does not impose tax on retirement income received by a nonresident after 12/31/95. For this purpose, retirement income means any income from any of the following:

- A qualified plan described in IRC Section 401;
- A qualified annuity plan described in IRC Section 403(a);
- A tax-sheltered annuity described in IRC Section 403(b);
- A governmental plan described in IRC Section 414(d);
- A deferred compensation plan maintained by a state or local government or an exempt organization described in IRC Section 457;
- An IRA described in IRC Section 7701(a)(37), including Roth IRA and SIMPLE;
- A simplified employee pension described in IRC Section 408(k);
- A trust described in IRC Section 501(c)(18);
- A private deferred compensation plan program or arrangement described in IRC Section 3121(v)(2)(C) **only** if the income is:

1. Part of a series of substantially equal periodic payments (not less frequently than annually) made over the life or life expectancy of the participant or those of the participant and the designated beneficiary or a period of not less than 10 years; or
2. A payment received after termination of employment under a plan program or arrangement maintained solely to provide retirement benefits for employees in excess of the limitations on contributions or benefits imposed by the IRC; or

- Any retirement or retainer pay received by a member or former member of a uniform service computed under Chapter 71 of Title 10, United States Code.

Military Pension

Nonresidents of California are not taxed on their military pension received after 12/31/95. Even if the military service was performed in California, California does not tax your military pension.

Get FTB Pub. 1032, Tax Information for Military Personnel, for more information.

Individual Retirement Arrangements (IRAs)

The California treatment of IRAs is generally the same as the federal treatment. For information on the federal treatment of IRAs, refer to federal Pub. 590, Individual Retirement Arrangements (IRAs) (Including SEP-IRAs and SIMPLE IRAs).

IRA Deduction

Following is a summary of the California IRA deductions allowed.

2002 through 2003

California law is the same as federal law. The IRA deduction for an individual under 50 years old is the lesser of $3,000 or 100% of your compensation. The IRA deduction for an individual who is 50 years old or over is the lesser of $3,500 or 100% of your compensation. For a SIMPLE IRA, an elective deferral may be made for up to $7,000 for 2002 and $8,000 for 2003 for an individual under 50 years old or $7,500 for 2002 and $9,000 for 2003 for an individual 50 years of age or older.

1987 Through 2001

California law is the same as federal law. The IRA deduction is the lesser of $2,000 or 100% of your compensation. If you are covered by an employer's retirement plan or if you file a joint return with your spouse who is covered by such a plan, you may be entitled to only a partial deduction or no deduction at all, depending on your income. See the federal instructions for more information. You can elect to designate otherwise deductible contributions as nondeductible. However, you do not have to elect the same treatment for California purposes that you did for federal purposes. For a SIMPLE IRA, an elective deferral may be made for up to $6,500 for 2001 and $6,000 for 1997 through 2000.

1982 Through 1986

California law was different from federal law. The maximum federal deduction for an individual was $2,000, and was available to active participants in qualified or government retirement plans and to persons who contributed to tax-sheltered annuities. The California IRA deduction was the lesser of $1,500 or 15% of compensation with an additional deduction for a nonworking spouse, for a maximum deduction of $1,750. An IRA deduction was not allowed if you were an active participant in a qualified or government retirement plan or contributed to a tax-sheltered annuity.

1976 Through 1981

California law was the same as federal law. The IRA deduction for an individual was the lesser of $1,500 or 15% of compensation. An IRA deduction was not allowed if you were an active participant in a qualified or government retirement plan or contributed to a tax-sheltered annuity.

1975

California law was different from federal law. California did not allow an IRA deduction. Therefore, income earned in 1975 and 1976 on the 1975 contribution was taxable. The federal deduction was the same as for years 1976-1981.

Note: After 12/31/95, your California IRA deduction is generally the same as your federal IRA deduction, and you should not make an adjustment to your federal AGI. Differences in the amount of IRA deduction you could claim may have occurred prior to 1/1/96 if there was a difference between your federal self-employment income and your California self-employment income.

Long Form 540NR Filers

If you file Long Form 540NR, your IRA deduction on Schedule CA (540NR), line 24, column E, is limited to the lesser of:

- The IRA deduction allowed on your federal return; or
- The compensation reported on your Schedule CA (540NR), column E.

Example:

You are a nonresident of California who is under 50 years of age. During the year, you worked temporarily in California. Your California compensation is $1,000, which you reported on Schedule CA, column E. Your allowable IRA deduction on your federal return is $3,000.

Determination: Your allowable California IRA deduction that you report on Schedule CA (540NR), column E, is $1,000. This is the lesser of (1) the $3,000 IRA deduction allowed on your federal return, or (2) the $1,000 of compensation you reported on Schedule CA (540NR), column E.

IRA Distribution

Residents of California

Your IRA distribution is fully taxable if your IRA contributions were fully deductible. If your IRA contributions were partially or fully nondeductible, then the nondeductible contributions are not taxed when they are distributed to you. Your basis is the amount of your nondeductible contributions. How you recover your basis depends on when your nondeductible contributions were made.

Nondeductible Contributions Made After 1986

If you made nondeductible contributions after 1986, a part of each distribution is considered a return of your basis and is not taxable. The California taxable amount will generally be the same as the federal taxable amount, and you should not make an adjustment to your federal AGI on Schedule CA (540) or Schedule CA (540NR).

However, if you elected to treat a contribution differently for federal purposes than for California purposes, the taxable amounts will differ. Compute the California taxable amount using the instructions for federal Form 8606, Nondeductible IRAs. When making this computation, for the recovery of nondeductible contributions made after 1987, make sure you **do not** include nondeductible contributions made before 1987. The nondeductible contributions made before 1987 will be recovered as explained in the following paragraph.

Compute the adjustment to federal AGI by comparing your federal taxable amount with the California taxable amount.

- If the federal amount is more than the California amount, enter the difference on Schedule CA (540 or 540NR), line 15b, column B, or Form 540A, Side 1, Step 4, line 13e.
- If the federal amount is less than the California amount, enter the difference on Schedule CA (540 or 540NR), line 15b, Column C or Form 540A, Side 1, Step 4, line 13e as a negative amount.

Nondeductible Contributions Made Before 1987

If you made nondeductible contributions before 1987, none of your distribution is taxed until you have recovered your pre-1987 basis. Because all contributions made before 1987 were deductible for federal purposes, there may be a difference in the California and federal taxable amounts. If there is a difference, you must make an adjustment to reduce your federal AGI to the correct taxable amount for California.

Your adjustment is the lesser of your:

- Pre-1987 California basis; or
- IRA distribution included in federal AGI.

Use Worksheet I — Part A on page 12 to compute your pre-1987 California basis. Use Worksheet I — Part B to compute your adjustment to federal AGI and your remaining pre-1987 California basis. See Example 1 and Example 2. Use Worksheet II as a summary of your California basis and its recovery.

If you have more than one IRA account, combine all your IRAs to complete the worksheet. If both you and your spouse have IRAs, you each must complete a separate worksheet based on your own IRA contributions, deductions, and distributions.

Nonresidents of California

California does not impose tax on retirement income, including income from an IRA, received by a nonresident after 12/31/95. If you need information regarding retirement income received by a nonresident prior to 1996, refer to the 1995 version of FTB Pub. 1005. See ''Where to Get Tax Forms and Publications" on page 11.

Change of Residency

California does not impose tax on retirement income, including income from an IRA, received by a nonresident after 12/31/95.

From resident to nonresident

- For IRA distributions received while you were a California resident, see Residents of California on page 4 for the taxability of your distributions.
- IRA distributions received while you were a nonresident after 12/31/95 are not taxable by California.

From nonresident to resident

- IRA distributions received while you were a nonresident after 12/31/95 are not taxable by California.
- For IRA distributions received while you were a California resident, see "2002 Law Changes IRA Basis of Former Nonresidents" below for how to determine your nontaxable IRA basis.

2002 Law Changes IRA Basis of Former Nonresidents – The law changed for taxable years beginning on or after January 1, 2002 and after. If you are a California resident who was a former nonresident, the new law may affect the taxation of your IRA income. The law affects not only individuals who became California residents in 2002, but also individuals who became California residents prior to 2002. Under prior law, when you became a resident, you received a stepped-up basis in your IRA equal to your annual contributions made while a nonresident, plus the earnings on your IRA while a nonresident. You were allowed to carry over this IRA basis until it was fully recovered. Beginning in 2002, you no longer have this stepped-up basis.

The law treats a former nonresident as though the individual were a resident for all prior years for all items of deferred income, including IRAs. Accordingly, a former nonresident will be allowed an IRA basis only for contributions which would not have been allowed as a deduction under California law had the taxpayer been a California resident. For a summary of IRA deductions allowed under California law, see IRA Deduction on page 4.

Do not include in California basis any rollover contributions from an employer sponsored or self-employed retirement plan, including a tax-sheltered annuity.

If you became a California resident prior to 2002 and you have an unrecovered stepped-up IRA basis that you were carrying into 2002, you must restate your IRA basis using the new law. See example 3 and example 4 on page 6 and page 7.

Example 1 – You were a California resident in 2003, and you received an IRA distribution of $800. The only other distribution received from your IRA was in 2002. The amount of the 2002 distribution was $700. You made the following contributions and deductions in prior years:

Year	Contributions	Federal Deductions	California
1981	$1,500	$1,500	$1,500
1982	2,000	2,000	1,500
1983	2,000	2,000	1,500
Total	$5,500	$5,500	$4,500

Determination: You would complete Worksheet I as follows:

Worksheet I — Figuring California Basis and Adjustment to Federal AGI

Part A Pre-1987 California Basis		**Example 1**
(If you have already computed your California basis as of 12/31/02; skip to Part B.)		
1 Enter your total federal deductions claimed prior to 1987.	**1**	$5,500
2 Enter your total California deductions claimed prior to 1987	**2**	4,500
3 Total California basis. Subtract line 2 from line 1	**3**	1,000
4 Enter your California basis previously recovered	**4**	700
5 California basis as of 12/31/02. Subtract line 4 from line 3	**5**	300

Part B Adjustment to Federal AGI and Remaining Pre-1987 California Basis		**Example 1**
1 Enter your taxable distribution from your federal Form 1040, line 15b (or line 16b), Form 1040A, line 11b (or line 12b)	**1**	$800
2 Enter your California basis as of 12/31/02[a)]	**2**	300
3 Enter the smaller of line 1 or line 2. Enter this amount on Schedule CA (540 or 540NR), line 15b or line 16b, column B, or Form 540A, Side 1, Step 4, line 13e or line 13f	**3**	300
4 Remaining California basis as of 12/31/03. Subtract line 3 from line 2	**4**	0

Included in your federal AGI is the $800 IRA distribution. Only $500 ($800 – $300) of the distribution is taxable by California in 2003. Your adjustment to federal AGI is $300. Your California basis has now been fully recovered. When you receive a distribution in later years, the amount of the distribution taxable for federal purposes will also be the amount taxable by California. No adjustment to federal AGI will be necessary.

a) A nonresident or former nonresident will no longer receive a stepped-up basis for annual contributions and earnings attributable to periods of nonresidency.

Example 2 – You were a California resident in 2003, and you received your first IRA distribution. The distribution was $1,000. For federal purposes, you included $800 in income and $200 was treated as the nontaxable recovery of your federal basis. You made the following contributions and deductions in prior years:

Year	Contributions Before 1987	Contributions After 1986	Federal Deductions	California Deductions Before 1987	California Deductions After 1986
1984	$2,000		$2,000	$0	
1985	2,000		2,000	0	
1986	2,000		2,000	0	
1987		$2,000	0		$0
Total	$6,000	$2,000	$6,000	$0	$0

Determination: You would complete Worksheet I as follows:

Worksheet I — Figuring California Basis and Adjustment to Federal AGI **Example 2**

Part A Pre-1987 California Basis (If you have already computed your California basis as of 12/31/02; skip to Part B.)

1	Enter your total federal deductions claimed prior to 1987.	1	$6,000
2	Enter your total California deductions claimed prior to 1987	2	0
3	Total California basis. Subtract line 2 from line 1	3	6,000
4	Enter your California basis previously recovered	4	0
5	California basis as of 12/31/02. Subtract line 4 from line 3	5	6,000

Part B Adjustment to Federal AGI and Remaining Pre-1987 California Basis **Example 2**

1	Enter your taxable distribution from your federal Form 1040, line 15b (or line 16b), Form 1040A, line 11b (or line 12b)	1	$ 800
2	Enter your California basis as of 12/31/02	2	6,000
3	Enter the smaller of line 1 or line 2. Enter this amount on Schedule CA (540 or 540NR), line 15b or line 16b, column B, or Form 540A, Side 1, Step 4, line 13e or line 13f	3	800
4	Remaining California basis as of 12/31/03. Subtract line 3 from line 2	4	5,200

Because your California basis is more than the distribution, none of your IRA distribution will be taxed by California in 2003. Your adjustment to federal AGI is $800. You have a remaining California IRA basis of $5,200. You will recover your remaining California basis in later years. You would use Worksheet II as follows to keep track of your California basis and its recovery:

Worksheet II — Summary of California Basis

Taxable Year	Pre-1987 Contributions	Deduction Federal	Deduction California	California Basis in Contribution	Total Distribution	Federal Taxable Amount	California Basis Recovered	Remaining California Basis
1984	$2,000	$2,000	$0	$2,000				$2,000
1985	2,000	2,000	0	2,000				4,000
1986	2,000	2,000	0	2,000				6,000
2003					$1,000	$800	$800	5,200

Example 3 – You became a California resident on January 1, 2001. The fair market value of your IRA on January 1, 2001, was $9,000. Your contributions in excess of California deduction limits during 1982-1986 were $2,500. You received IRA distributions of $1,500 in 2001, $3,000 in 2002, and $2,000 in 2003.

Determination:

Taxable year 2001 (prior law):

California IRA basis, January 1, 2001	$9,000 (Fair market value on 1/1/01)
Less: IRA distribution	1,500
California IRA basis, December 31, 2001	$7,500

Taxable year 2002 (new law):

IRA distribution, 2002		$3,000
Less: California IRA basis		
Contributions in excess of California deduction limits	$2,500	
Less: California IRA basis recovered in 2001	1,500	
California IRA basis available in 2002		1,000
Taxable IRA income		$2,000

Taxable year 2003:

IRA distribution, 2003	$2,000
Less: California IRA basis available in 2003	-0-
Taxable IRA income	$2,000

Example 4 – You became a California resident on 1/1/02. In 2001, while you were still a nonresident of California, you received a $50,000 lump-sum distribution from your employer's retirement plan and rolled over the distribution to an IRA. The earnings on your IRA in 2001 were $2,000. You received your first distribution from your IRA in 2002. The distribution was $4,000, all of which was taxable for federal purposes. Your California basis is determined as follows:

Determination:

Taxable year 2001 (prior law):

California IRA basis, January 1, 2001	$2,000	(earnings while a nonresident)
Less: IRA distribution in 2001	-0-	
California IRA basis, December 31, 2001	$2,000	

Taxable year 2002 (new law):

IRA distribution:		$4,000
Less: California IRA basis		
Contributions in excess of California deduction limits	$ -0-	
Less: Basis recovered in prior years	-0-	
California IRA basis		-0-
Taxable IRA income		$4,000

Note: California IRA basis, December 31, 2002, is $-0-.

A nonresident or former nonresident will no longer receive a stepped-up basis for annual contributions and earnings attributable to periods of nonresidency.

Coverdell Education Savings Account (ESA)

Under a Coverdell ESA, contributions are not deductible, earnings are excludable, and distributions are not taxable if used for qualified educational expenses. In general, California conforms to the federal rules regarding contribution limits, income phaseout limits and the treatment of distributions. Get federal Publication 970, Tax Benefits for Higher Education, for more information. If you have a taxable distribution from a Coverdell ESA, get form FTB 3805P, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, to figure the additional tax.

Archer Medical Savings Accounts (MSAs)

An MSA is a tax-exempt trust or custodial account set up in the United States exclusively for paying the qualified medical expenses of the account holder or the account holder's spouse or dependent(s) in conjunction with a high deductible health plan (HDHP). Get federal Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, for more information.

Use federal Form 8853 to report general information about new MSAs, to figure your MSA deduction, and to figure your taxable distribution for MSAs. In general, California law is the same as federal law regarding MSA contributions and deductions, but is different regarding the amount of additional tax on MSA distributions not used for qualified medical expenses. The additional tax is 10% for California.

Therefore, for California purposes, there is no separate form to file to report general information about new MSAs or to figure your MSA deduction. However, if you have a taxable MSA distribution, you must file form FTB 3805P.

Roth IRA

In General

A Roth IRA is an individual retirement plan that differs from a traditional IRA by the way contributions and distributions are taxed. Contributions to a Roth IRA are never deductible, and, if you meet the requirements, qualified distributions are tax free.

California law conforms to federal law regarding Roth IRAs. All Roth IRA transactions must be treated the same way for California purposes as they are for federal purposes and no California adjustment will be necessary unless you converted a traditional IRA into a Roth IRA and the California basis of the converted IRA was different from the federal basis. The following paragraphs provide information about calculating the California adjustment if one is necessary.

Roth IRA Conversions

The tax due as the result of a conversion may be different for California purposes than for federal purposes if you:

- Made a conversion from a traditional IRA to a Roth IRA; and
- The federal basis of the traditional IRA was different from the California basis.

Use the Roth IRA Worksheet on page 8 to figure the amount that is taxable for California and the adjustment you must enter on Schedule CA (540 or 540NR).

Roth IRA Distributions

In general, the taxable amount of your Roth IRA distribution will be the same for California and federal purposes. However, the taxable portion of your distribution may be different for California purposes than for federal purposes if you:

- Made a 1998 conversion from a traditional IRA to a Roth IRA;
- Elected to report the taxable portion of the conversion over 4 years; and
- The federal basis of the traditional IRA was different from the California basis.

In this case, you will need to refigure federal Form 8606, Nondeductible IRAs, Part III, using California amounts. Your adjustment will be the difference between line 23 of Form 8606 completed with federal amounts and line 23 of Form 8606 completed with California amounts. If the:

- Federal amount is more than the California amount, include the difference on Schedule CA (540 or 540NR), line 15, column B.
- California amount is more than the federal amount, include the difference on Schedule CA (540 or 540NR), line 15, column C.

Nonresidents of California

California does not impose tax on retirement income, including income from a Roth IRA conversion or a Roth IRA distribution, received by a nonresident after 12/31/95.

Roth IRA Worksheet

Do Not Mail This Record

Do not file this worksheet with your return. Keep it for your tax records.

Conversions from Traditional IRAs to Roth IRAs

Part A – Pre-1987 California Basis

1 Enter your total federal IRA deductions claimed prior to 1987 . . . . . **1** __________

2 Enter your total California IRA deductions claimed prior to 1987 (or the deductions you could have claimed had you been a California resident) . . . . . **2** __________

3 Total California pre-1987 basis. Subtract line 2 from line 1 . . . . . **3** __________

4 Enter your pre-1987 California basis previously recovered . . . . . **4** __________

5 Pre-1987 California basis as of 12/31/02. Subtract line 4 from line 3 . . . . . **5** __________

Part B – Post-1986 California Basis

6 Enter your total IRA contributions made after 1986. (Enter only contributions made to traditional IRAs. Do not include contributions to Roth IRAs.) . . . . . **6** __________

7 Enter your total California IRA deductions claimed after 1986 . . . . . **7** __________

8 Subtract line 7 from line 6 . . . . . **8** __________

9 Enter your post-1986 California basis previously recovered . . . . . **9** __________

10 Total California post-1986 basis. Subtract line 9 from line 8. If the result is zero, skip line 11 through line 15, enter zero on line 16, and continue to line 17 . . . . . **10** __________

11 Enter the total amount of distributions from traditional IRAs during 2003 that were converted to Roth IRAs (as shown on line 16 of federal Form 8606) . . . . . **11** __________

12 Enter the value of all your traditional IRAs as of 12/31/03 (include any outstanding rollovers from traditional IRAs to other traditional IRAs) . . . . . **12** __________

13 Enter the total distributions from traditional IRAs (including amounts converted to Roth IRAs as shown on line 16 of federal Form 8606) received in 2003 . . . . . **13** __________

14 Add line 12 and line 13 . . . . . **14** __________

15 Divide line 11 by line 14, and enter the result as a decimal here. Carry the decimal to at least four places . **15** __ . __ __ __ __

16 Post-1986 basis recoverable against a 2003 distribution. Multiply line 10 by line 15 . . . . . **16** __________

Part C – Adjustment to Federal AGI

17 Enter the total amount of distributions from traditional IRAs during 2003 that were converted to Roth IRAs (as shown on line 16 of federal Form 8606) . . . . . **17** __________

18 **a** Enter the amount from Part A, line 5 . . . . . **18a** __________

b Enter the amount from Part B, line 16 . . . . . **18b** __________

c Add line 18a and line 18b . . . . . **18c** __________

19 Subtract line 18c from line 17. This is the total 2003 California taxable amount resulting from a 2003 conversion of a traditional IRA to a Roth IRA . . . . . **19** __________

20 Enter the 2003 federal taxable amount of a distribution resulting from a 2003 conversion of a traditional IRA to a Roth IRA (included on Form 1040, line 15) . . . **20** __________

21 Figure Your California Adjustment . . . . . **21** __________

If line 19 is less than line 20, subtract line 19 from line 20 and enter the result here and include it on Schedule CA (540 or 540NR), line 15, Column B.

If line 20 is less than line 19, subtract line 20 from line 19 and enter the result here and include it on Schedule CA (540 or 540NR), line 15, Column C.

Part-Year Residents. The taxable amount of a distribution from a traditional IRA (that is being converted to a Roth IRA in 2003) is included in your California source income only if you were a resident of California on the date of the distribution.

Simplified Employee Pension (SEP)

Deduction

Beginning with taxable year 1996, the allowable California SEP deduction is the same as the federal deduction.

Prior to 1/1/96, there may have been a difference in the amount of the SEP deduction you claimed if there was a difference between your federal self-employment income and your California self-employment income (residents, part-year residents, or nonresidents of California).

Long Form 540NR filers. Your SEP deduction on Schedule CA (540NR), column E is based upon the percentage of self-employment income from Schedule CA (540NR), column E to total self-employment income computed according to California law on Schedule CA (540NR), column D.

Multiply the SEP deduction from Schedule CA (540NR), column D by the ratio of California source self-employment income to total self-employment income. Enter this figure on Schedule CA (540NR), column E, line 30.

$$\frac{\text{Self-employment income from Schedule CA (540NR), column E}}{\text{Self-employment income from Schedule CA (540NR), column D}} \times \text{Schedule CA (540NR), line 30, column D}$$

Distribution

Nonresidents of California after 12/31/95:
California does not impose tax on retirement income, including income from a SEP, received by a nonresident after 12/31/95.

Residents of California:
The distribution of a SEP is treated the same as the distribution of an IRA. If you have a California basis for contributions made before 1987, your distribution is first considered a nontaxable return of your California basis. Once your California basis is recovered, your distribution will be reported the same as federal.

If you have a California basis from contributions made after 1986 and before 1996 due to differences in the amounts of net income from self employment you reported for federal and California purposes, your California basis will be recovered on a pro-rata basis in the same manner as are post 1986 nondeductible IRA contributions under federal law.

Use Worksheet I — Part A on page 12 to compute your pre-1987 California basis. Then use Worksheet I — Part B to compute your adjustment to federal AGI and your remaining pre-1987 California basis. Use Worksheet II as a summary of your California basis and its recovery.

California Basis. Your California basis is the amount of your SEP contributions that were not allowed as a deduction on your California return prior to 1987. A nonresident or former nonresident will no longer receive a stepped-up basis for annual contributions and earnings attributable to periods of nonresidency.

Self-Employed Retirement Plans (KEOGHs)

The California treatment of Keoghs is generally the same as the federal treatment. For information on the federal treatment of Keoghs, refer to federal Publication 560, Retirement Plans for Small Business.

Deduction

Beginning with taxable year 1996, your allowable California Keogh deduction is generally the same as your federal Keogh deduction.

Prior to 1/1/96, there may have been a difference in the amount of the Keogh deduction you claimed if there was a difference between your federal self-employment income and your California self-employment income (residents, part-year residents, or nonresidents of California).

Long Form 540NR filers. Your Keogh deduction on Schedule CA (540NR), column E is based upon the percentage of self-employment income from Schedule CA (540NR), column E to total self-employment income computed according to California law on Schedule CA (540NR), column D.

Multiply the Keogh deduction from Schedule CA (540NR), column D by the ratio of California source self-employment income to total self-employment income. Enter this figure on Schedule CA (540NR), column E, line 30.

$$\frac{\text{Self-employment income from Schedule CA (540NR), column E}}{\text{Self-employment income from Schedule CA (540NR), column D}} \times \text{Schedule CA (540NR), line 30, column D}$$

Example 1 — You are a part-year resident of California. Your total self-employment income for the year is $300,000, and the amount to be reported on Schedule CA (540NR), line 12, column E, is $100,000. Your Keogh deduction for federal purposes is $15,000. Your Keogh deduction to be reported on Schedule CA (540NR), line 30, column E is computed as follows:

$$\frac{\$100,000}{\$300,000} \times \$15,000 = \$5,000$$

Report $5,000 on Schedule CA (540NR), column E, line 30.

Distribution

Nonresidents of California after 12/31/95. California does not impose tax on retirement income, including income from a Keogh plan, received by a nonresident after 12/31/95.

Residents of California. The taxable amount of your Keogh distribution for California will be different from the federal taxable amount if you have a California basis to recover.

California Basis. Your California basis is the amount of Keogh contributions in excess of California deduction limits in effect prior to 1996. For taxable years prior to 1987, California limited deductions for contributions to defined contribution Keogh plans to 10% of earned income or $2,500, whichever was less. For years after 1986 but before 1996, California conformed to federal law regarding deduction limits, but did not necessarily adopt federal earned income figures for computing the deduction limitation. Accordingly, a self-employed individual has a California basis for any amounts contributed during these years for which the individual did not receive a California deduction.

A nonresident or former nonresident does not have a California basis in a Keogh for all contributions and earnings attributable to periods of nonresidency. Nonresidents and former nonresidents have a California basis only if they contributed more than would have been allowed as California deductions had they been residents of the state.

Recovery of California Basis. Your Keogh distribution is first considered to be a nontaxable return of your California basis. Therefore, when you receive your distribution, none of the distribution will be taxed until you have recovered your California basis. Once you have recovered your California basis, your distribution must be reported the same as for federal purposes.

If you have received a distribution and you have a California basis, you must make an adjustment on Schedule CA (540 or 540NR) to reduce your federal AGI to the correct taxable amount for California. Your Schedule CA (540 or 540NR) adjustment is the lesser of your:

- Pre-1987 California basis; or
- Keogh distribution included in federal AGI.

Use Worksheet I – Part A on page 12 to compute your pre-1987 California basis. Then use Worksheet I – Part B to compute your adjustment to federal AGI and your remaining pre-1987 California basis. Use Worksheet II as a summary of your California basis and its recovery.

Exception: If you made voluntary contributions that were not deductible on your federal and California returns, do not include the amount of the voluntary contributions in your California basis. The recovery of the voluntary contributions for California is treated the same as the recovery for federal purposes. **Do not** make an adjustment on Schedule CA (540 or 540NR) or Form 540A, Side 1, Step 4, line 13e or line 13f to recover your voluntary contributions.

Lump-sum Distribution

If you received a qualified lump-sum distribution and are using Schedule G-1, Tax on Lump-Sum Distributions, follow the revised instructions below when completing Worksheet I – Part B:

- Line 1. Enter the taxable distribution from your federal Form 1099-R, box 2a.
- Line 3. Enter the smaller of line 1 or line 2. Compute the amounts to enter on Schedule G-1 as follows:

California taxable amount	=	federal Form 1099-R, box 2a	–	Worksheet I Part B, line 3

Enter the California taxable distribution on Schedule G-1, line 8 unless the capital gain election was made. If the capital gain election was made:

Sch. G-1, line 6	=	California taxable amount	X	federal Form 1099-R, box 3 / federal Form 1099-R, box 2a
Sch. G-1, line 8	=	California taxable amount	–	Sch. G-1, line 6

Change in Residency

California Resident. A California resident is taxed on all income, regardless of its source. If you are a California resident and receive a Keogh distribution attributable to your non-California self-employment income, your distribution minus your California basis is taxable by California.

Nonresident of California. California does not impose tax on retirement income, including income from a Keogh plan, received by a nonresident after 12/31/95.

Tax on Early Distributions

California has a tax on early distributions from IRAs, any qualified retirement plans, annuities, and modified endowment contracts. This tax is generally the same as federal except the California tax rate is 2 1/2% rather than 10%, except for early distributions from SIMPLE plans during the two-year period beginning on the date the taxpayer first began participation in the plan. In that case, the tax rate is 6% rather than 25%. California does not have taxes similar to the federal tax on excess accumulations, tax on excess contributions, or tax on excess distributions.

Early Distributions. Early distributions are amounts you withdraw from your qualified retirement plan, annuity, or modified endowment contract before you are age 59 1/2. The tax on early distributions is 2 1/2% of the amount of the distribution included in income or 6% in the case of an early distribution from a SIMPLE plan during the first two-year period beginning on the date the taxpayer first began participation in the plan. The tax on early distribution is imposed in addition to any regular California income tax on the distribution. You must figure this tax on form FTB 3805P, Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts.

Exceptions: The tax on early distributions does not apply to:

- The portion of the distribution that is a return of basis;
- Distributions made due to total and permanent disability;
- Distributions made as a part of a series of substantially equal payments made for the life (or joint lives) of you and your designated beneficiary (if from a qualified employee plan, payments must begin after separation from service);
- Distributions due to death (does not apply to modified endowment contracts);
- Distributions made to you to the extent you have medical expenses deductible under IRC Section 213 (does not apply to modified endowment contracts);
- Distributions made to unemployed individuals for health insurance premiums (applies only to IRAs);
- Distributions made for qualified higher education expenses (applies only to IRAs);
- Distributions of up to $10,000 made for first home purchases (applies only to IRAs);
- Distributions made to you after you separated from service with your employer in or after the year in which you reached age 55 (applies only to qualified employee plans);
- Distributions made to an alternate payee under a qualified domestic relations order (applies only to qualified employee plans);
- Distributions due to an IRS levy; or
- Distributions due to an FTB notice to withhold on a qualified retirement plan.

Get form FTB 3805P for additional exceptions.

Prohibited Transactions. You may also owe tax on early distributions from an IRA or SEP if you enter into a prohibited transaction. If you enter into a prohibited transaction, your IRA ceases to be an IRA on the first day of the taxable year and you are considered to have received a distribution of the entire value of your IRA. If you are under age 59 1/2 on the first day of the taxable year, you are subject to the tax on early distributions. Get form FTB 3805P for more information.

California Credits

Exemption Credit for Seniors Age 65 or Older

California allows an additional exemption credit for individuals who are age 65 or older at the end of the tax year rather than the larger standard deduction allowed on the federal return. Be sure to claim this credit on your California income tax return if you qualify.

Additional Information

Where To Get Tax Forms and Publications

By Internet – You can download, view, and print California tax forms and publications from our Website at **www.ftb.ca.gov.**

By phone – Use our automated toll-free phone service to order 2001, 2002, and 2003 California and 2003 federal tax booklets. Call (800) 338-0505, select personal income tax, then tax forms and publications, and follow the recorded instructions. The automated toll-free phone service is available 24 hours a day, 7 days a week. Please allow two weeks to receive your order. If you live outside of California, please allow three weeks to receive your order.

In person – Many libraries, post offices, and banks provide free California tax booklets during the filing season. Most libraries and some quick print businesses have forms and schedules to photocopy (a nominal fee may apply). **Note:** Employees at libraries, post offices, banks, and quick print businesses cannot provide tax information or assistance.

By mail – Write to:

TAX FORMS REQUEST UNIT
FRANCHISE TAX BOARD
PO BOX 307
RANCHO CORDOVA CA 95741-0307

Letters

If you write to us, be sure to include your social security number, your daytime and evening telephone numbers, and a copy of the notice with your letter. Send your letter to:

FRANCHISE TAX BOARD
PO BOX 942840
SACRAMENTO CA 94240-0040

We will respond to your letter within ten weeks. In some cases, we may need to call you for additional information.

General Toll-Free Phone Service

Telephone assistance is available year-round from 7 a.m. until 7 p.m. Monday through Friday, except state holidays. We may modify these hours without notice to meet operational needs.

From within the United States, call . . . . (800) 852-5711
From outside the United States, call (not toll-free) (916) 845-6500
For federal tax questions, call the IRS at . . . . (800) 829-1040

Assistance for persons with disabilities
We comply with the Americans with Disabilities Act. Persons with hearing or speech impairments please call TTY/TDD Phone (800) 822-6268.

Asistencia bilingüe en español

Asistencia telefónica esta disponible todo el año durante las 7 a.m. y las 7 p.m. lunes a viernes, excepto días festivos estatales. Sin embargo, podríamos modificar este horario sin aviso previo para cumplir necesidades de operación.

Dentro de los Estados Unidos, llame al . . . . (800) 852-5711
Fuera de los Estados Unidos,
llame al (cargos aplican) . . . . (916) 845-6500
Para preguntas sobre impuestos federales,
llame el IRS al . . . . (800) 829-1040

Página Electrónica:
www.ftb.ca.gov

Asistencia para personas discapacitadas: Nosotros estamos en conformidad con el Acta de Americanos Discapacitados. Personas con problemas auditivos o de habla, pueden llamar al (800) 822-6268 con un aparato de telecomunicación TTY/TDD.

Basis Worksheets

Worksheet I — Figuring California Basis and Adjustment to Federal AGI

Part A Pre-1987 California Basis

(If you have already computed your California basis as of 12/31/02 and have always been a California resident; skip to Part B.)

1 Enter your total federal deductions claimed prior to 1987. . . . . **1** ____________

2 Enter your total California deductions claimed prior to 1987 (or the deductions you could have claimed had you been a California resident) . . . . **2** ____________

3 Total California basis. Subtract line 2 from line 1 . . . . **3** ____________

4 Enter your California basis recovered in prior years . . . . **4** ____________

5 California basis as of 12/31/02. Subtract line 4 from line 3 . . . . **5** ____________

Part B Adjustment to Federal AGI and Remaining Pre-1987 California Basis

1 Enter your taxable distribution from your federal Form 1040, line 15b (or line 16b), Form 1040A, line 11b (or line 12b). . . . . **1** ____________

2 Enter your California basis as of 12/31/02. [a] . . . . **2** ____________

3 Enter the smaller of line 1 or line 2. Enter this amount on Schedule CA (540 or 540NR), line 15b or line 16b or Form 540A, Side 1, Step 4, line 13e or line 13f . . . . **3** ____________

4 Remaining California basis as of 12/31/03. Subtract line 3 from line 2 . . . . **4** ____________

Worksheet II — Summary of California Basis

Taxable Year	Pre-1987 Contributions	Deduction		California Basis in Contribution	Total Distribution	Federal Taxable Amount	California Basis Recovered	Remaining California Basis
		Federal	California					

a) A nonresident or former nonresident will no longer receive a stepped-up basis for annual contributions and earnings attributable to periods of nonresidency.