

What's New and Other Important Information for 2005

Differences between California and Federal Law

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 regarding California and federal law, please visit our Website at www.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), and the Business Entity tax booklets.

Note, 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.

2005 Tax Law Changes

Recently enacted legislation changes California's specified date of conformity to federal income tax laws from January 1, 2001 to January 1, 2005. This date change, in general, conforms to numerous changes made in the federal income tax law during that four-year period. For the most current information regarding specific provisions of conformity and non-conformity as it relates to this date change, please visit our Website at www.ftb.ca.gov and search for **conformity**.

California conforms to federal law for the following:

- For purposes of the Child and Dependent Care Expenses Credit, compensation received by a member of the armed forces for active service shall be considered earned income, whether or not the member is domiciled in this state.
- An exclusion for qualified foster care payments.
- The uniform definition of a child.
- Qualifying expenses associated with the adoption of children with special needs.

Head of Household Filing Status

Beginning in 2005, for a child to qualify as your foster child for head of household purposes, the child must either be placed with you by an authorized placement agency or by order of a court.

If you are unmarried, your unmarried child no longer qualifies you for head of household filing status if he or she is 19 years of age or older, is not a student, and has gross income equal to or greater than the federal exemption amount (\$3,200 in 2005). In addition, if you are unmarried, your unmarried child also no longer qualifies you for the status if he or she is under 19 years of age or a student under 24 and pays more than half of his or her own support.

California does not conform to federal law for the following:

- Exclusion from gross income of certain federal subsidies for prescription drug plans.
- Exclusion of survivor benefits attributable to service by a public safety officer who is killed in the line of duty before January 1, 1997.
- Recovery period for depreciation of certain leasehold improvements and restaurant property.

Other Federal Conformity Items

California conforms to federal law to allow the following:

- California conforms to the Federal statutes that limit or preempt California's ability to tax the California source income of certain nonresidents employed in interstate commerce, and members of the armed forces.

Federal Non-conformity Items

- California does not conform to Federal law with regard to income attributable to domestic production activities.
- The exclusion of settlement payments including related interest received by an eligible individual defined as a person persecuted on the basis of race or religion by the regime that was in control of the Ottoman Turkish Empire from 1915-1923.

Mental Health Services Tax

Proposition 63, approved by voters on November 2, 2004, enacted the Mental Health Services Act, which imposes an additional 1% tax on taxable income over \$1,000,000. Please refer to the worksheet on page 23 to compute the additional tax to be reported on your Long Form 540NR.

Underpayment of Estimated Tax Penalty

For taxable years beginning on or after January 1, 2005, the underpayment of estimated tax penalty shall not apply to the extent the underpayment of an installment was created or increased by any provision of law that is chaptered during and operative for the taxable year of the underpayment. To request a waiver of the underpayment of estimated tax penalty, get form FTB 5805, Underpayment of Estimated Tax by Individuals and Fiduciaries or form FTB 5805F, Underpayment of Estimated Tax by Farmers and Fishermen.

Shasta County Wildfires/Southern California Flooding

If you were a victim of the Shasta County Wildfires, Southern California Flooding, Debris Flows or Mudslides, get FTB Pub. 1034, *How to Claim a State Tax Deduction for your Disaster Loss*, for more information.

Amnesty

Recently enacted law provides clarification and relief for taxpayers who participated in the 2005 California state Amnesty program. For more information visit our Website at www.ftb.ca.gov and search for the **Amnesty** link.

Tax Shelter

If you were involved in a potentially abusive tax shelter, then you may have a disclosure, registration, and/or a list maintenance requirement. Attach the IRS Form 8886 to the back of your California return along with your other supporting schedules. If this is the first time the reportable transaction is disclosed on the return, then send a duplicate copy of the Form 8886 to the

address below. The Franchise Tax Board may impose several new penalties if you fail to file IRS Forms 8886, 8264, or any other required information.

Tax Shelter Filing
Franchise Tax Board
PO Box 1673
Sacramento CA 95812-1673

For more information, see Registration and Reporting Requirements under Abusive Tax Shelters on our Website at www.ftb.ca.gov.

Other Important Information

New California Form CA Sch W-2

For taxable years beginning on or after January 1, 2005, you can use the CA Sch W-2 to report certain W-2 information. You should attach this schedule to side 2 of your income tax return. You can keep your W-2's for your records. This is an optional form, as you can still attach your W-2's to the front of your return if you choose not to complete the CA Sch W-2.

Prior Name Line

There is a new line on the Long and Short Form 540NR for taxpayers who may have filed their 2004 income tax returns under a different last name. If you had a different last name, please write the last name **only** from your 2004 tax return on this new line.

New Voluntary Contribution Funds

You may make voluntary contributions to the following funds:

- Veterans' Quality of Life Fund
- California Sexual Violence Victim Services Fund
- California Colorectal Cancer Prevention Fund

Environmental Tax Credit – For taxable years beginning on or after July 1, 2005, California allows an environmental tax credit in an amount equal to five cents (\$.05) for each gallon of ultra low sulfur diesel fuel produced during the taxable year by a small refiner at any facility located in California. The aggregate credit cannot exceed 25 percent of the qualified capital costs incurred by the small refiner with respect to that facility, reduced by the aggregate credits determined for all prior taxable years with respect to that facility. See form FTB 3511, Environmental Tax Credit, for more information.

Charitable Contribution for the 2004 Tsunami Disaster – If you reported a charitable contribution deduction for the relief of victims in the Tsunami Disaster in 2004, you are not allowed a deduction for the same charitable contribution in 2005. However, if you made additional charitable contributions that were not claimed as a deduction in 2004, these additional contributions may be reported as a deduction in 2005.

Katrina Tax Relief Act – As of the date of publishing, California has not conformed to any of the federal law changes made under the Katrina Emergency Tax Relief Act of 2005. However, California will follow federal policy by allowing special tax relief for California taxpayers affected by Hurricane Katrina in the federally declared disaster areas for the items listed below:

- Extended due dates for filing tax returns and paying taxes;
- Donations of approved employee leave time program;

- Qualified distributions from qualified pension plans.

For more information related to Hurricane Katrina, visit our Website at www.ftb.ca.gov and see Disaster loss under the Filing tab.

Net Operating Loss – For taxable years beginning on or after January 1, 2004, California has reinstated the Net Operating Loss (NOL) carryover deduction. The carryover periods for NOL deductions that were incurred:

- beginning before January 1, 2002, has been extended for two years.
- beginning on or after January 1, 2002, and before January 1, 2003, has been extended for one year.

Natural Heritage Preservation Credit – The funding for the Natural Heritage Preservation Credit is available beginning January 1, 2005.

Common Errors and How to Prevent Them

Help us process your return quickly and accurately. When we find an error we must stop to verify the information on the return, which slows processing. The most common errors are claiming the wrong estimated tax payments, claiming the wrong exemption credit, claiming the wrong amount of real estate withholding, and making tax computation errors.

To avoid these errors and to help FTB process your return faster, please use these helpful hints when preparing your return.

When claiming Estimated Payments:

- Verify that the amount of estimated payments claimed on your return matches what you sent to the FTB for that year. Check our Website at www.ftb.ca.gov and select Check your account to view your total estimated payments before you file your return.
- If the amount of estimated payments claimed on your tax return does not match FTB records, you will receive a Return Information Notice to explain the difference.

When totaling your Exemptions:

- Be sure to add the exemption amounts correctly and transfer the total exemption amount to the correct line of the return. (See the individual line instructions for assistance).

When computing your Tax:

- Check our Website at www.ftb.ca.gov and access the automatic tax table to compute your tax, or
- Make sure to locate the correct tax amount from the tax table (in this booklet) and transfer it to your return correctly.

When claiming real estate withholding:

- Remember to claim the amount withheld for real estate sold in California during 2005. Your escrow company should have provided you with a California Form 593-B, Real Estate Withholding Tax Statement, indicating the amount withheld. For details, see the Long Form 540NR line 48 instructions on page 24.

By using the helpful hints listed above, delays in processing your return and unnecessary account adjustments can be prevented.