

# Supplemental Guidelines to California Adjustments

## What's Changed?

The California legislature enacted SB 615 (Stats. 2004.CH.388), which makes California law compatible with the Servicemembers Civil Relief Act (Public Law 108-189). This means that servicemembers domiciled outside of California and their spouses 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.

## General Information

In general, California law conforms to the Internal Revenue Code (IRC) as of January 1, 2001. Therefore, California has conformed to the income

tax changes made to the IRC by the federal Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206), the Tax and Trade Relief Extension Act of 1998 (Public Law 105-277), the Surface Transportation Revenue Act of 1998 (Public Law 105-178), the Ricky Ray Hemophilia Relief Fund Act of 1998 (Public Law 105-369), the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170), the Miscellaneous Trade and Technical Corrections Act of 1999 (Public Law 106-36), the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (Public Law 106-519), the Consolidated Appropriations Act of 2001 (Public Law 106-554), and to technical corrections made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16). However, there are continuing differences between California and Federal law. California has not conformed to some of the law changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) or the federal Job Creation and Worker Assistance Act of 2002 (Public Law 107-147).

## Purpose

Use these guidelines to make adjustments to federal adjusted gross income that are necessary because of current year or prior year differences between California and federal law. Generally, you report these adjustments directly on Schedule CA (540), California Adjustments — Residents (or Schedule CA (540NR), California Adjustments — Nonresidents or Part-Year Residents).

If you are required to make multiple adjustments for any one line on Schedule CA (540 or 540NR), attach a schedule to your return summarizing these adjustments.

In some cases you need to complete other forms or schedules to figure the adjustment to carry to Schedule CA (540 or 540NR). See "Order Forms and Publications" on the back cover of your tax booklet for information about ordering forms.

ITEM	DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW	WHAT TO DO FOR CALIFORNIA
<b>Wages, Salaries, Tips, etc.</b>		
<ul style="list-style-type: none"> <li>Military pay</li> </ul>	Special rules apply to active duty military pay. Native Americans with military pay also see "Earnings of American Indians" on page 2.	Get FTB Pub. 1032 for more information.
<ul style="list-style-type: none"> <li>Sick pay received under the Federal Insurance Contributions Act and Railroad Retirement Act</li> </ul>	California excludes from income the sick pay received under these Acts.	Enter qualifying sick pay included in federal income on Schedule CA (540 or 540NR), line 7, column B.
<ul style="list-style-type: none"> <li>Income exempted by U.S. treaties</li> </ul>	Income exempted by treaty under federal law may be excluded for California only if the treaty specifically excludes the income for state purposes.	Enter the amount excluded from federal income on Schedule CA (540 or 540NR), line 7, column C.
<ul style="list-style-type: none"> <li>Employee income exclusions for ridesharing programs</li> </ul>	Federal law provides an income exclusion for the value of parking provided to an employee up to \$175 per month and for transit passes provided to an employee up to \$65 per month.  California law provides an income exclusion for compensation or the fair market value of other benefits (except for salary or wages) received for participation in a California ridesharing arrangement (subsidized parking, commuting in a third-party vanpool, a private commuter bus, a subscription taxipool, and monthly transit passes provided for employees and their dependents).  Under federal law and the provisions administered by the Employment Development Department, qualified transportation benefits are excluded from gross income. Under the California Revenue and Taxation Code, there are no monthly limits for the exclusion of these benefits and California's definitions are more expansive.	Enter the amount of ridesharing benefits received and included in federal income on Schedule CA (540 or 540NR), line 7, column B.
<ul style="list-style-type: none"> <li>California Qualified Stock Options (CQSOs)</li> </ul>	California law provides an income exclusion for California qualified stock options (issued on or after 1/1/97 and before 1/1/2002), that are exercised by an individual who has earned income for the taxable year from the corporation granting the CQSO of \$40,000 or less; and has exercised options for no more than 1,000 shares with a combined fair market value of less than \$100,000 (determined at the time the options are granted). Get FTB Pub. 1004, Stock Option Guidelines, for more information.	Enter on Schedule CA (540 or 540NR), line 7, column B the amount included in federal income that qualifies for the California exclusion.
<ul style="list-style-type: none"> <li>Medical Expenses</li> </ul>	California allows an exclusion from gross income for employer-provided accident, health insurance, and medical expense reimbursement for domestic partners and that partner's dependents if they were not previously deducted. Self-employed individuals may also claim a deduction for health insurance costs paid for domestic partners and the partners dependents.	Enter on Schedule CA (540 or 540NR), line 7, column B the amount included in federal income.

ITEM	DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW	WHAT TO DO FOR CALIFORNIA
<ul style="list-style-type: none"> <li>Earnings of American Indians</li> </ul>	<p>California does not tax income earned by tribal members who live in Indian country affiliated with their tribe and receive earnings from the same tribal source of which they are members. Military compensation is considered income from tribal sources. For more information, get FTB 674, Frequently Asked Questions About the Income Taxation of American Indians.</p> <p>Native Americans who receive military compensation must re-figure any AGI percentage calculation(s) by first subtracting military compensation from Federal AGI.</p>	
<b>Taxable Interest Income</b>		
<ul style="list-style-type: none"> <li>Non-California bonds:               <ol style="list-style-type: none"> <li>United States</li> <li>Other states</li> </ol> </li> </ul>	<p>Federal law requires the interest earned on federal bonds (U.S. obligations) to be included in gross income. California does not tax this interest income. The following are not considered U.S. obligations for California purposes: Federal National Mortgage Association (Fannie Mae); Government National Mortgage Association (Ginnie Mae); or Federal Home Loan Mortgage Corporation (Freddie Mac).</p> <p>Federal law does not tax interest from state or local bonds. California taxes the interest from non-California state and local bonds.</p>	<p>Enter the amount of federal bond interest included in federal income on Schedule CA (540 or 540NR), line 8, column B.</p> <p>Enter the interest from non-California state or local bonds on Schedule CA (540 or 540NR), line 8, column C.</p>
<ul style="list-style-type: none"> <li>Loans made to a business located in an enterprise zone</li> </ul>	<p>California law allows a deduction from income for the amount of net interest received from loans made to a trade or business located within an enterprise zone. Federal law has no comparable deduction.</p>	<p>Use form FTB 3805Z, Enterprise Zone Deduction and Credit Summary. Transfer the net interest deduction from form FTB 3805Z to Schedule CA (540 or 540NR), line 8, column B. Write "FTB 3805Z" next to the dotted line on Form 540 or Long Form 540NR, line 14.</p>
<ul style="list-style-type: none"> <li>Interest income received in conjunction with the refund of the smog impact fee</li> </ul>	<p>California law provides an income exclusion for interest received from the State of California in conjunction with the refund of the smog impact fee for individuals who were not allowed to deduct the smog impact fee when it was paid.</p>	<p>Enter the interest on Schedule CA (540 or 540NR), line 8, column B.</p>
<ul style="list-style-type: none"> <li>Grants paid to low-income individuals</li> </ul>	<p>California law allows an income exclusion for grants paid to low-income individuals to construct or retrofit buildings to be more energy efficient. Federal law has no similar exclusion.</p>	<p>Enter the amount included in federal AGI on Schedule CA (540 or 540NR), line 21f, column B.</p>
<ul style="list-style-type: none"> <li>Rebates or vouchers from a local water agency, energy agency, or energy supplier</li> </ul>	<p>California law allows an income exclusion for rebates or vouchers from a local water agency, energy agency, or energy supplier for the purchase and installation of water conservation appliances and devices. Federal law has no similar exclusion.</p>	<p>Enter the amount included in federal AGI on Schedule CA (540 or 540NR), line 21f, column B.</p>
<ul style="list-style-type: none"> <li>Payments made for wrongful incarceration</li> </ul>	<p>California law allows an income exclusion for payments made due to a determination of wrongful incarceration.</p>	<p>Enter the amount included in federal AGI on Schedule CA (540 or 540NR), line 21f, column B.</p>
<b>Dividend Income</b>		
<ul style="list-style-type: none"> <li>Exempt interest dividends (Mutual Funds)</li> </ul>	<p>California taxes "exempt interest dividends" derived from non-California state or Municipal obligations, but does not tax "exempt interest-dividends" derived from U.S. obligations or from California state or Municipal obligations IF the fund holds at least 50% of its assets in obligations that would be exempt from California tax when held by an individual.</p>	<p>If the amount of U.S. and California state or municipal obligations are at least 50% of the fund's total assets, report only the amount of exempt interest dividends that are not attributed to California tax-exempt obligations. Report the amount on Schedule CA (540) line 9 or Schedule CA (540NR), line 9, column B.</p>
<ul style="list-style-type: none"> <li>Controlled foreign corporation (CFC)</li> </ul>	<p>California taxes CFC dividends in the year distributed rather than in the year earned.</p>	<p>Enter the amount of the CFC dividend on Schedule CA (540 or 540NR), line 9, column C.</p>
<ul style="list-style-type: none"> <li>Regulated investment company (RIC)</li> </ul>	<p>California taxes the undistributed capital gain from a RIC in the year distributed rather than in the year earned.</p>	<p>Enter the distribution on Schedule CA (540 or 540NR), line 9, column C.</p>
<ul style="list-style-type: none"> <li>Distributions of pre-1987 earnings from S corporations</li> </ul>	<p>Prior to 1987, California treated all federal S corporations as C corporations. So when a federal S corporation first becomes a California S corporation, its initial accumulated adjustments account (AAA) has a zero balance regardless of the federal AAA balance. If distributions from the S corporation exceed the California balance in the AAA, you have a distribution from pre-1987 earnings.</p>	<p>Enter distributions from pre-1987 earnings (or earnings in any later year that the corporation was a federal S corporation and a California C corporation) on Schedule CA (540 or 540NR), line 9, column C.</p>
<ul style="list-style-type: none"> <li>Noncash patronage dividend from farmers' cooperatives or mutual associations</li> </ul>	<p>Federal law taxes the dividend in the year of receipt. California permits an election to include the dividend in gross income either when received or when redeemed. Once an election is made, this method must be followed unless a change in the method of reporting is approved by the Franchise Tax Board (FTB).</p>	<p>If you elect or elected to include the dividend in the year redeemed, enter the amount received in 2002 on Schedule CA (540 or 540NR), line 9, column B. Enter the amount redeemed in 2002 on Schedule CA (540 or 540NR), line 9, column C.</p>
<b>Taxable Refunds, Credits, or Offsets of Local Income Taxes</b>		
<ul style="list-style-type: none"> <li>State income tax refund</li> </ul>	<p>Federal law includes the state income tax refund in income. California excludes the state income tax refund from income.</p>	<p>Enter the amount of state income tax refund included in federal income on Schedule CA (540 or 540NR), line 10, column B.</p>

ITEM	DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW	WHAT TO DO FOR CALIFORNIA
<b>Alimony Paid</b>		
<ul style="list-style-type: none"> <li>Alimony paid by a nonresident alien</li> </ul>	Alimony expense paid by a nonresident alien that was not deducted on the federal return is a deduction on the California return.	Enter the amount not included on your federal return on Schedule CA (540 or 540NR), line 33a, column C.
<b>Alimony Received</b>		
<ul style="list-style-type: none"> <li>Alimony received by a nonresident alien</li> </ul>	Alimony which was not included on the federal return must be included on the California return.	Enter the amount not included in federal income on Schedule CA (540 or 540NR), line 11, column C.
<b>Business Income or (Loss) — Depreciation, Amortization, and Property Expensing</b>		
<ul style="list-style-type: none"> <li>Income from a business, trade, or profession conducted partially in California</li> </ul>	If a nonresident owns a business, trade, or profession carried on within California that is an integral part of a unitary business carried on both within and outside California, the amount of such income having its source in California is determined in accordance with the provisions of the Uniform Division of Income for Tax Purposes Act.	Gross income from the entire business, trade, or profession is included in the nonresident's adjusted gross income from all sources. The nonresident's California source business income is generally determined by a 4-factor apportionment formula (property, payroll, and sales). Refer to Title 18, Cal. Code Reg. Section 17951.
<ul style="list-style-type: none"> <li>Asset expense election (IRC Section 179)</li> </ul>	Federal law allows an expense election up to \$24,000 of the cost of certain business property in lieu of depreciation. California and federal law are the same.	Use form FTB 3885A to figure the necessary adjustment to make on Schedule CA (540 or 540NR) only if you make a different election for California.
<ul style="list-style-type: none"> <li>MACRS recovery period for nonresidential real property</li> </ul>	For federal purposes, the recovery period for nonresidential real property is 39 years. California conformed to this provision on 1/1/97. The California recovery period of 31.5 years should be used for property placed in service on or after 5/13/93, and before 1/1/97.	Use form FTB 3885A to figure the depreciation adjustment to make on Schedule CA (540 or 540NR).
<ul style="list-style-type: none"> <li>Depreciation of assets acquired prior to 1/1/87</li> </ul>	Federal law allowed the rapid write-off of tangible personal property and buildings over recovery periods which were shorter than economic useful lives under the Accelerated Cost Recovery System (ACRS). California law in general was not conformed to federal law but did allow ACRS for certain residential rental property constructed in California on or after 7/1/85, and before 1/1/87.	Use form FTB 3885A to figure the adjustment to make on Schedule CA (540 or 540NR).
<ul style="list-style-type: none"> <li>Depreciation</li> </ul>	Federal law allowed an additional first-year depreciation deduction and AMT depreciation adjustment for property placed in service after September 10, 2001. California has not conformed to this provision.	Use form FTB 3885A to figure the adjustment to make on Schedule CA (540 or 540NR).
<ul style="list-style-type: none"> <li>Amortization of goodwill and certain other intangibles</li> </ul>	Property classified as IRC Section 197 property under federal law is also Section 197 property for California purposes. However, for Section 197 property acquired before 1/1/94, the California basis as of 1/1/94, must be amortized over the remaining federal amortization period.	Use form FTB 3885A to figure the adjustment to make on Schedule CA (540 or 540NR).
<ul style="list-style-type: none"> <li>Business property moves into California</li> </ul>	Depreciation methods and useful lives of trade or business property must be acceptable to California.	If an unacceptable method was used before the move into California, use the straight-line method to compute the basis in the property.
<ul style="list-style-type: none"> <li>Enterprise Zone, Local Agency Military Base Recovery Area (LAMBRA), or Targeted Tax Area (TTA) business expense deduction</li> </ul>	Federal law has no comparable deduction. A California enterprise zone business may elect to immediately expense up to \$40,000 of the cost of qualified property. A California LAMBRA business may elect to immediately expense up to \$40,000 of the cost of qualified property. A California TTA business may elect to immediately expense up to \$40,000 of the cost of qualified property. For California purposes, you may not take an IRC Section 179 deduction on any asset used to calculate the business expense deduction.	Use form FTB 3805Z, form FTB 3807, or form FTB 3809. Enter the business expense deduction from form FTB 3805Z, form FTB 3807, or form FTB 3809 on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B. Use form FTB 3885A to figure any depreciation adjustment to make on Schedule CA (540 or 540NR)
<ul style="list-style-type: none"> <li>Accelerated depreciation for property on Indian reservations</li> </ul>	Under federal law, certain property on Indian reservations placed in service after 1/1/94, and before 12/31/2004, will be subject to special MACRS recovery periods. California did not conform to this provision. See IRS Publication 3991.	Use form FTB 3885A to figure the depreciation adjustment to make on Schedule CA (540 or 540NR).
<ul style="list-style-type: none"> <li>Pollution control facilities</li> </ul>	Both California and federal law provide for accelerated write-off of pollution control facilities. California law only allows the write-off of facilities located in California.	Enter the amortization for the California facilities on form FTB 3885A. Compare the California amortization to the federal amortization and enter the difference on Schedule CA (540 or 540NR), line 12 or line 17, column C.
<ul style="list-style-type: none"> <li>Expenditure for tertiary injectants incurred in the crude oil industry</li> </ul>	Federal law allows a deduction for the cost of tertiary injectants which are part of a tertiary recovery system. California law allows a depreciation deduction if the tertiary injectant qualifies as property used in a trade or business or is held for the production of income.	Enter the amount of tertiary injectants deducted on your federal return on Schedule CA (540 or 540NR), line 12, column C. Attach a schedule reflecting the depreciation computation of tertiary injectants placed in service during 2002. Then complete form FTB 3885A.
<ul style="list-style-type: none"> <li>Reduced recovery periods for fruit bearing grapevines replaced in a California vineyard on or after 1/1/92, as a result of phylloxera infestation on or after 1/1/97, as a result of Pierce's disease</li> </ul>	Federal law generally requires a 10-year recovery period for fruit bearing vines for purposes of accelerated cost recovery and a 20-year recovery period for those vines under an alternative depreciation system. California law allows 5 and 10-year recovery periods, respectively.	Prepare a schedule reflecting the depreciation computation of grapevines placed in service on or after 1/1/92 (for phylloxera infestation), and placed in service on or after 1/1/97 (for Pierce's disease). Then complete form FTB 3885A and attach it and your depreciation schedule to your return.

ITEM	DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW	WHAT TO DO FOR CALIFORNIA
• Water utility property	Under federal law, certain water utility property that otherwise have had a 20-year recovery period and any municipal sewer, will be depreciated over 25 years. The increased recovery period applies to property placed in service after 6/12/96, other than property placed in service under a binding contract in effect before 6/10/96. California does not conform to this provision and you must continue to use a 20-year recovery period.	Use form FTB 3885A to figure the depreciation adjustment to enter on Schedule CA (540 or 540NR).
• Income forecast method of depreciation	For assets placed in service after 8/5/97, federal law limits the income forecast method of depreciation to film, video tape, sound recordings, copyrights, books, patents, and other property to be specified by federal regulations. California conformed to this limitation for assets placed in service after 12/31/97.	Use form FTB 3885A to figure the depreciation adjustment to enter on Schedule CA (540 or 540NR).
• Clean fuel and electric vehicles classified as luxury automobiles	For electric vehicles and automobiles equipped to qualify as clean-burning fuel vehicles placed in service after 8/5/97, and before 1/1/2005, federal law allows a modified depreciation limitation equivalent to triple the IRC Section 280F limitation for other luxury automobiles. California conformed to this provision for assets placed in service after 12/31/97.	Use form FTB 3885A to figure the depreciation adjustment to enter on Schedule CA (540 or 540NR).
<b>Business Income or (Loss) — Adjustments to Basis or Business Deductions</b>		
• Donated agricultural products transportation credit	Federal law has no comparable credit. Under California law, deductions are not allowed for the portion of expenses equal to the credit.	Enter on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C, the portion of the deduction claimed on your federal return that was used to claim the California credit.
• Farmworker housing credit	Federal law has no comparable credit. Under California law, deductions are not allowed for the portion of expenses equal to the credit.	Enter on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C, the portion of the deduction claimed on your federal return that was used to claim the California credit.
• Rice straw credit	Federal law has no comparable credit. Under California law, deductions are not allowed for the portion of expenses equal to the credit.	Enter on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C, the portion of the deduction claimed on your federal return that was used to claim the California credit.
• Clean fuel vehicles first year deduction	California has not conformed with federal for the first year deduction on Clean Air Fuel.	Enter the amount deducted from federal income on the total for Schedule CA (540 or 540NR), line 34, column B.
• Basis adjustment for sales or use tax credit for property used in an Enterprise Zone, a LAMBRA, the Targeted Tax Area (TTA), or the former LARZ.	Federal law has no comparable credit, but IRC Section 164(a) requires an increase in basis for the amount of sales or use tax paid. Under California law, depreciation is computed based on cost, without regard to the sales or use tax allowed as a credit. Federal and state basis will differ due to the increase in federal basis by the addition of the sales or use tax.	Use form FTB 3805Z, form FTB 3807, form FTB 3809, or form FTB 3806 to claim the sales or use tax credit for property used in an Enterprise Zone, a LAMBRA, the TTA, or the former LARZ. Complete form FTB 3885A, Part III if you are depreciating the cost of the property in excess of the allowable credit.
• Credit for employer-paid child care center and services	Federal law allows a deduction for all ordinary and necessary trade or business expenses. Under California law, employers may claim a credit for establishing a child care program or contributing to a child care referral service. Deductions are not allowed for that portion of expenses equal to the credit. Reduce the basis of any child care facility by the amount of the credit attributable to the facility in the year the credit is allowed.	Enter 30% of the amount of deductions claimed on your federal return to operate a child care program or contribute to the referral service on Schedule CA (540 or 540NR), line 12, column C. Then complete form FTB 3885A.
• Credit for employer-paid child care plan	Federal law allows a deduction for all ordinary and necessary trade or business expenses. Under California law, employers and building owners may claim a credit of 30% of contributions to a qualified care plan on behalf of any dependent under the age of 12 of the employer's California employee. Deductions are not allowed for that portion of the expenses equal to the amount of the credit. If the contribution to the plan is used at a facility owned by the employer, the basis of the facility must be reduced by the amount of the credit attributable to the facility in the year the credit is allowed.	Enter 30% of the amount of deductions claimed on your federal return for costs paid for contributions to a qualified care plan made on behalf of a California employee's dependent(s) under the age of 12 on Schedule CA (540 or 540NR), line 12, column C. Then complete form FTB 3885A.
• Enhanced oil recovery credit	Federal law allows a credit for up to 15% of qualified costs attributable to qualified enhanced recovery oil projects. The basis of the enhanced recovery oil projects must be reduced by the amount of the credit. California conforms to this provision, except that only California projects qualify for the state credit, and the amount of the credit is limited to 1/3 of the federal credit amount.	Get form FTB 3546, Enhanced Oil Recovery Credit.
• Solar Energy System Credit	California law allows taxpayers to claim a credit for the purchase and installation of a solar energy system. The credit is the lesser of 15% of the costs and installation of a solar energy system or \$4.50 per rated watt of generating capacity of the system.	Get form FTB 3508, Solar Energy System Credit.

ITEM	DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW	WHAT TO DO FOR CALIFORNIA
<ul style="list-style-type: none"> <li>Joint Strike Fighter Wage Credit/Joint Strike Fighter Property Credit</li> </ul>	<p>California allows a credit for 50% of qualified wages paid or incurred, not to exceed \$10,000 for each qualified employee, or a proportional amount for an employee who is employed by the taxpayer for only part of the taxable year for duties related to a joint strike fighter. Federal has no comparable credit. California allows a credit for 10% of the cost of property placed in service in California for ultimate use in a joint strike fighter. Federal law has no similar credit.</p>	<p>Get form FTB 3534, Joint Strike Fighter Credit.</p>
<ul style="list-style-type: none"> <li>Disabled access credit for eligible small businesses</li> </ul>	<p>Federal law allows a credit of 50% for the cost of making a business accessible to disabled individuals. No deduction is permitted for any amount for which a disabled access credit is allowed. California conforms to this provision, but the maximum credit is \$125 (50% of eligible expenses up to \$250).</p>	<p>Get form FTB 3548, Disabled Access Credit for Eligible Small Businesses.</p>
<ul style="list-style-type: none"> <li>Indian employment credit</li> </ul>	<p>Under federal law, a nonrefundable credit is available to employers for certain wages and health insurance costs paid or incurred by the employer after 1/1/94, for certain full-time or part-time employees who also are enrolled members of an Indian tribe or are spouses of enrolled members. California did not conform to this provision.</p>	<p>Enter the amount of business expense denied under federal law on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B.</p>
<ul style="list-style-type: none"> <li>Abandonment or tax recoupment fees for open-space easements and timberland preserves</li> </ul>	<p>Federal law allows a deduction for expenses incurred in a trade or business or held for the production of income. California denies a deduction for fees paid by California property owners on termination of open-space easements or timberland preserve status.</p>	<p>Enter the amount of fees incurred and deducted on your federal return on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C.</p>
<ul style="list-style-type: none"> <li>Enterprise Zone, LAMBRA, or Manufacturing Enhancement Area (MEA) hiring credit</li> </ul>	<p>Under California law, employers may claim a hiring credit related to an Enterprise Zone, a LAMBRA, or an MEA. Deductions for the wages upon which the credit is based must be reduced by the amount of credit.</p>	<p>Enter the amount of wages (from form FTB 3805Z, form FTB 3807, or form FTB 3808) equal to the amount of your California credit on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C.</p>
<ul style="list-style-type: none"> <li>Real Estate Professionals – Material participation in a rental real estate activity</li> </ul>	<p>Beginning with the 1994 tax year and for federal purposes only, rental real estate activities conducted by persons in a real property business are not automatically treated as passive activities. California did not conform to this provision and these activities are still considered passive under California law.</p>	<p>To figure the adjustment to make on Schedule CA (540 or 540NR), line 17, use form FTB 3801 and include these activities when completing the California Worksheet and the California Adjustment Worksheet in the instructions for form FTB 3801.</p>
<ul style="list-style-type: none"> <li>Research Credit</li> </ul>	<p>Federal law allows a credit for research expenses and requires that the deduction for research expenses be reduced by the amount of the credit allowed. California conforms to federal law, but requires the amount of research expenses to be reduced by the amount of the California credit. In addition, California law requires the use of the California tax bracket when determining the elective credit amount.</p>	<p>Enter the amount of research expenses deducted on your federal return on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C. Enter the amount of California research expenses after reduction for California research credit on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B.</p>
<ul style="list-style-type: none"> <li>Property for which a public utility provided an energy conservation subsidy on or after 1/1/95, and before 1/1/97</li> </ul>	<p>Federal law allows an exclusion from income for any subsidy provided directly or indirectly by a public utility for the purchase or installation of any energy conservation measure with respect to a dwelling unit. The adjusted basis of the property must be reduced by the amount excluded from income. California does not conform for amounts received after 12/31/94, and before 1/1/97.</p>	<p>Use form FTB 3885A to figure the adjustment to enter on Schedule CA (540 or 540NR).</p>
<ul style="list-style-type: none"> <li>Employer wage expenses for Work Opportunity Credit and Welfare-To-Work Credit</li> </ul>	<p>Federal law allows a Work Opportunity Credit and a Welfare-To-Work Credit for employers that hire individuals from certain target groups and recipients of long-term family assistance. Employers that claim these credits must reduce their wage expense by the amount of the credits. California has no similar credits.</p>	<p>Enter the amount of the federal Work Opportunity Credit or Welfare-To-Work Credit that reduced the federal deduction for wages on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B.</p>
<ul style="list-style-type: none"> <li>Qualified clinical testing expenses</li> </ul>	<p>Federal law allows an Orphan Drug Credit for qualified clinical testing expenses incurred in testing drugs for rare diseases or conditions. A business must reduce its deduction for qualified clinical testing expenses by the amount of the credit. California has no similar credit.</p>	<p>Enter the amount of the federal Orphan Drug Credit that reduced the federal deduction for qualified clinical testing expenses on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B.</p>
<ul style="list-style-type: none"> <li>Business Expense</li> </ul>	<p>California does not allow a deduction for business expenses incurred at a club that discriminates.</p>	<p>Enter on Schedule CA (540 or 540NR) line 12, column C, the amount taken as a federal deduction.</p>
<ul style="list-style-type: none"> <li>Qualified environmental cleanup costs</li> </ul>	<p>Federal law allows an election to currently deduct costs paid or incurred on or after 8/5/97, for cleanup costs at a qualified contaminated site. California did not conform to this provision until 1/1/98. Therefore, before 1/1/98, such costs were classified as capital expenditures for California purposes.</p>	<p>Use form FTB 3885A to figure the adjustment to enter on Schedule CA (540 or 540NR).</p>
<b>Capital Gains and Losses</b>		
<ul style="list-style-type: none"> <li>Gain on sale or disposition of a qualified assisted housing development to low-income residents or to specified entities who maintain housing for low-income residents</li> </ul>	<p>Federal law does not allow special treatment on gains related to the sale of certain assisted housing. California law permits the deferral of such gain, under certain conditions, if the proceeds are reinvested in residential real property (other than a personal residence) within two years of the sale.</p>	<p>Enter the transaction on California Schedule D (540 or 540NR), line 1. In column (e) enter “-0- R&amp;TC Section 18041.5.” Reduce the basis of replacement property by the gain deferred. Attach a schedule to your return reflecting computation of basis in the replacement property, or a statement of intent to replace within the replacement period.</p>

ITEM	DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW	WHAT TO DO FOR CALIFORNIA
<ul style="list-style-type: none"> <li>Gain on sale of personal residence</li> </ul>	<p>For sale or exchanges after 5/6/97, federal law allows an exclusion of gain on the sale of a personal residence in the amount of \$250,000 (\$500,000 if married filing jointly). The taxpayer must have owned and occupied the residence as a principal residence for at least 2 of the 5 years before the sale. California conforms to this provision. However, taxpayers who served in the Peace Corps during the 5 year period ending on the date of the sale may reduce the 2 year period by the period of service, not to exceed 18 months.</p>	<p>Report gain on the sale of a personal residence on California Schedule D (540 or 540NR), line 1, column (e). Cost or other basis plus expense of sale must reflect adjustment for depreciation allowed or allowable for California purposes.</p>
<ul style="list-style-type: none"> <li>Undistributed capital gains for regulated investment company (RIC) shareholders</li> </ul>	<p>Federal law requires certain undistributed capital gains reported on federal Form 2439 to be included in the gross income of the mutual fund shareholder and allows a tax credit for the capital gains tax paid by the RIC. California has no similar provision.</p>	<p>Do not enter the amount of undistributed capital gains on California Schedule D (540 or 540NR).</p>
<ul style="list-style-type: none"> <li>Gain or loss on sale of property inherited before 1/1/87</li> </ul>	<p>Federal gain or loss may differ from the California gain or loss due to differences in the basis of property. For more information, get FTB Pub. 1039, Basis of Property-Decedent and Surviving Spouse. For property inherited after 1/1/87, the California basis and the federal basis are the same.</p>	<p>Report the amount of California capital gains and losses on California Schedule D (540 or 540NR).</p>
<ul style="list-style-type: none"> <li>Capital loss carrybacks</li> </ul>	<p>Federal law allows a deduction for carrybacks of certain capital losses. California has no similar provision.</p>	<p>Report the amount of California capital gains and losses on California Schedule D (540 or 540NR).</p>
<ul style="list-style-type: none"> <li>Exclusion of gain on the sale of qualified small business stock</li> </ul>	<p>Federal law allows an exclusion under IRC Section 1202 of 50% of the gain on the sale of qualifying small business stock originally issued after 8/10/93, that was held for more than five years. California law provides a similar exclusion (under R&amp;TC Section 18152.5); however, for California purposes, 80% of the issuing corporation's payroll must be attributable to employment located within California, and at least 80% of the value of the issuing corporation's assets must be used by the corporation to actively conduct one or more qualified trades or businesses in California.</p>	<p>Use California Schedule D (540 or 540NR) if you claim the federal IRC Section 1202 exclusion on your federal return.</p>
<b>Other Gains or Losses</b>		
<ul style="list-style-type: none"> <li>Basis differences of business property</li> </ul>	<p>The California basis of assets may be different than the federal basis due to differences between California and federal law, which may affect the gain or loss on disposition.</p>	<p>Get Schedule D-1, Sales of Business Property, to figure the adjustment to make on Schedule CA (540 or 540NR).</p>
<b>IRA Distribution</b>		
<ul style="list-style-type: none"> <li>IRA basis adjustments</li> </ul>	<p>There may be differences in the taxable amount of the distribution depending on when the contributions were made, if you changed residency status after you first began making contributions to your IRA or made different deductions for California because of differences between your California and federal self-employment income. You will need to calculate your IRA basis as if you were a California resident for all prior years.</p>	<p>Get FTB Pub. 1005, Pension and Annuity Guidelines, for more information.</p>
<ul style="list-style-type: none"> <li>Roth IRAs</li> </ul>	<p>Federal law and California law are the same regarding contributions, conversions, and distributions. However, the taxable amount of a distribution may not be the same because of basis differences.</p>	<p>Get FTB Pub. 1005, Pension and Annuity Guidelines, for more information.</p>
<b>Pensions and Annuities</b>		
<ul style="list-style-type: none"> <li>Railroad retirement benefits</li> </ul>	<p>California does not tax railroad retirement benefits reported on federal Form RRB 1099-R.</p>	<p>Enter on Schedule CA (540 or 540NR), line 16, column B, the amount of tier 1 (non-Social Security equivalent) or tier 2 railroad retirement benefits included in adjusted gross income on your federal return.</p>
<ul style="list-style-type: none"> <li>Pension Plan – Small Business Tax Credit for New Retirement Plan Expenses</li> </ul>	<p>Federal law allows an income tax credit for 50% of the first \$1,000 in administrative and retirement-education expenses for any small business that adopts a new qualified defined benefit or defined contribution plan. The Federal deduction is reduced by the amount of the credit. California has no similar credit.</p>	<p>Enter the amount of the income tax credit on Schedule CA (540 or 540NR), line 16, column B.</p>
<ul style="list-style-type: none"> <li>Employer-sponsored pensions and annuities (for annuity starting dates after 7/1/86, and before 1/1/87) if you elected to use the "three-year rule" for California</li> </ul>	<p>Under federal law, no "three-year rule" is allowed for any individual whose annuity starting date is after 7/1/86. Under California law, an individual whose annuity starting date was after 7/1/86, and before 1/1/87, could elect to use the "three-year rule" if: 1) The employer paid part of the cost and 2) During the three years from the date of the first annuity payment, the total amount receivable will equal or exceed the cost (investment) in the contract.</p>	<p>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, an adjustment is required. Enter the difference on Schedule CA (540 or 540NR), line 16, column C. Get FTB Pub. 1005, Pension and Annuity Guidelines, for more information.</p>
<b>Unemployment Compensation</b>		
<ul style="list-style-type: none"> <li>Unemployment compensation</li> </ul>	<p>California does not tax unemployment compensation.</p>	<p>Enter on Schedule CA (540 or 540NR), line 19, column B, the amount of unemployment compensation you included in adjusted gross income on your federal return.</p>

ITEM	DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW	WHAT TO DO FOR CALIFORNIA
<b>Social Security Benefits</b>		
<ul style="list-style-type: none"> <li>Social security benefits and equivalent tier 1 railroad retirement benefits</li> </ul>	<p>California does not tax social security benefits and equivalent tier 1 railroad retirement benefits.</p>	<p>Enter on Schedule CA (540 or 540NR), line 20, column B, the amount of social security benefits and equivalent tier 1 railroad retirement benefits you included in adjusted gross income on your federal return.</p>
<b>Rents, Royalties, Partnerships, Estates, Trusts, etc.</b>		
<ul style="list-style-type: none"> <li>Pass-through of income and deductions from partnerships, S corporations, estates, and trusts</li> </ul>	<p>Items of income and deduction from pass-through entities may differ due to various differences between federal and state law. Refer to federal Schedule K-1 (1065), or Schedule Q in the case of REMICs, to determine items of income and deduction for federal purposes. Refer to California Schedules K-1 (100S, 541, 565, or 568) to determine items of income and deduction from pass-through entities for California purposes.</p>	<p>Follow the instructions for Schedules K-1 (100S, 541, 565, or 568). Some items are reported directly on Schedule CA (540 or 540NR), line 17, and some items must be reported on other forms and schedules.</p>
<ul style="list-style-type: none"> <li>Accumulation distribution to beneficiaries on which the required California taxes have not been paid by a trust</li> </ul>	<p>Federal law taxes the accumulated income of a trust under IRC Sections 665-668. If a trust has a California resident trustee or beneficiary, the beneficiary is non-contingent, and the trust has not filed a California return and paid California tax as the income was accumulated, then the full amount of the accumulation distribution is taxable to the beneficiary in the year the accumulation distribution is received.</p>	<p>If you received a federal Schedule J (1041) and did not receive a California Schedule J (541), an adjustment is required because the trust did not file a California return and pay the tax as the income was accumulated. The accumulation distribution from federal Schedule J (1041) must be adjusted for California purposes. This information must be provided by the trustee.</p>
<ul style="list-style-type: none"> <li>Accumulation distribution to beneficiaries on which the trust was not required to pay California tax because the beneficiaries' interest was contingent</li> </ul>	<p>Federal law taxes the accumulated income of a trust under IRC Sections 665-668. If a trust has a California resident trustee or beneficiary, the beneficiary is contingent, and the trust has not filed a California return and paid California tax as the income was accumulated, then the beneficiary is entitled to the benefit of income averaging under the provisions of R&amp;TC Sections 17745(b) and (d).</p>	<p>Use California form FTB 5870A, Tax on Accumulation Distribution of Trusts, to compute the part of the accumulation distribution includable in your 2002 California adjusted gross income.</p>
<ul style="list-style-type: none"> <li>Amounts included in gross income of United States shareholders from foreign corporations</li> </ul>	<p>Under federal law, IRC Section 951, if a foreign corporation is a controlled foreign corporation (CFC) for an uninterrupted period of 30 days or more during any taxable year, then U.S. shareholders who own stock in a CFC on the last day of the taxable year in which it was a CFC must include in gross income their pro-rata share of income. The pro-rata shares are included in the income of U.S. shareholders even though there may be intervening entities in a chain between a CFC and such shareholders. California has no similar provision.</p>	<p>Enter the amount of income received from a CFC and included in federal income on Schedule CA (540 or 540NR), line 17, column B.</p>
<b>Other Income</b>		
<ul style="list-style-type: none"> <li>Net Operating Loss (NOL)</li> </ul>		
<ol style="list-style-type: none"> <li>Disaster loss carryover</li> </ol>	<p>The allowable disaster loss carryover under California law is different than the allowable disaster loss carryover under federal law.</p>	<p>Enter as a positive number on Schedule CA (540 or 540NR), line 21b, column B, from your 2001 form FTB 3805V.</p>
<ol style="list-style-type: none"> <li>Federal NOL deduction</li> </ol>	<p>Due to differences between federal and California law, you must refigure your NOL carryover for California purposes.</p>	<p>Enter as a positive number on Schedule CA (540 or 540NR), line 21c, column C, the federal NOL deduction. Use form FTB 3805V to figure the California NOL carryover.</p>
<ol style="list-style-type: none"> <li>California NOL deduction</li> </ol>	<p>The NOL deduction has been suspended for 2002 and 2003.</p>	<p>Suspended for 2002 and 2003.</p>
<ol style="list-style-type: none"> <li>NOL deduction from Enterprise Zones, LAMBRAAs, the TTA, the former LARZ, or Pierce's disease</li> </ol>	<p>The NOL deduction has been suspended for 2003 and 2003.</p>	<p>Suspended for 2002 and 2003.</p>
<ul style="list-style-type: none"> <li>Original issue discount (OID) for debt instruments issued (and loans made) in 1985 and 1986</li> </ul>	<p>In the tax year in which the debt instrument matures, is sold, exchanged, or otherwise disposed of, you must recognize the difference between the amount reported on your federal return and the amount reported for California purposes.</p>	<p><b>Issuer (debtor)</b> – Enter the difference between the federal deductible amount and the California deductible amount on Schedule CA (540 or 540NR), line 21f, column B.</p>
<ul style="list-style-type: none"> <li>Income exempted by U.S. tax treaties</li> </ul>	<p>California is not affected by U.S. treaties with foreign countries unless they specifically apply to state income taxes. If a treaty does not specifically exempt income from state income tax, California requires the reporting of adjusted gross income from all sources.</p>	<p><b>Holder (lender)</b> – Enter the difference between the amount included in federal gross income and the amount included for California purposes on Schedule CA (540 or 540NR), line 21f, column C.</p>
<ul style="list-style-type: none"> <li>Foreign income of nonresident aliens</li> </ul>	<p>Federal Form 1040NR, U.S. Nonresident Alien Income Tax Return, and federal Form 1040NR-EZ, U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents, requires that only United States source income be reported. California requires the reporting of adjusted gross income from all sources.</p>	<p>Adjust federal income to reflect worldwide income computed under California statutes. Enter losses from foreign sources on Schedule CA (540 or 540NR), line 21f, column B. Enter foreign source income on Schedule CA (540 or 540NR), line 21f, column C.</p>

ITEM	DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW	WHAT TO DO FOR CALIFORNIA
• California lottery winnings	California does not tax California lottery winnings. California does tax lottery winnings from other states.	Enter on Schedule CA (540 or 540NR), line 21a, column B, the amount of California lottery winnings included in adjusted gross income on your federal return.
• Reward from a crime hotline	California does not tax a reward authorized by a government agency and received from a crime hotline established by a government agency or nonprofit organization.	Enter on Schedule CA (540 or 540NR), line 21f, column B, the amount of such a reward you included in adjusted gross income on your federal return.
• Income received from a recycling center or location for empty beverage containers	Federal law taxes beverage container recycling income. California law does not tax income received by a consumer for recycling empty beverage containers.	Enter the amount of beverage container recycling income reported on your federal return on Schedule CA (540 or 540NR), line 21f, column B.
• Rebates from water agencies or suppliers	Federal law taxes rebates received from water agencies or suppliers. California law does not tax those rebates.	Enter the amount of rebate received from water agencies or suppliers and included in federal income on Schedule CA (540 or 540NR), line 21f, column B.
• Foreign-earned income and housing expense exclusion	Under federal law, IRC Section 911, a qualified individual may elect to exclude certain foreign-earned income and an employer-provided housing allowance. California has no similar provision.	Enter the amount of foreign-earned income and housing allowance under IRC Section 911 on Schedule CA (540 or 540NR), line 21f, column C.
• Refinancing of certain student loans	Federal law allows an exclusion from gross income for refinancing of existing student loans after 8/5/97, on loans made by certain tax-exempt organizations. In general, California conforms to this provision regarding the refinancing of student loans; however, California allows the exclusion only for loans made by educational organizations, and does not conform to the requirement that the refinancing must be made under a program of refinancing that requires the student to fulfill a supervised public service requirement.	For amounts excluded from federal income due to the refinancing of student loans where the loan is made by an organization other than an educational organization, enter the amount of refinanced debt excluded on your federal return on Schedule CA (540 or 540NR), line 21f, column C.
• Humanitarian reparations payments to persons required to perform slave or forced labor during World War II	California excludes from income any amount received as reparation payments paid by the German Foundation known as Remembrance, Responsibility, and the Future, or any other source of humanitarian reparations made for purposes of redressing the injustice done to persons who were required to perform slave or forced labor during World War II.	Enter the amount of your reparation payments on Schedule CA (540 or 540NR), line 21f, column B.
• Educator Expense	Federal law allows a deduction for qualified expenses for teachers, instructors, counselors, principals, or aides for K-12 grades. California has not conformed.	Enter the amount on line 23, column B.
• Student loan interest	Federal law allows a deduction for student loan interest and has eliminated the 60-month limitation. However, California will allow the interest paid on student loans for the first 5 years or 60 months.	Enter on line 25, column B, the interest deducted on the federal return after the first 60 months.
• Tuition and Fees deduction	Federal law allows a deduction from income up to \$3,000 for qualified higher education expenses paid. California has not conformed	Enter the amount on line 26, column B.
<b>Itemized Deductions</b>		
• Taxes		
1) Minimum tax paid by a limited partnership	Federal law allows a deduction for franchise taxes. California specifically disallows this deduction.	Add the amount of your federal deduction for franchise taxes paid to the amount on Schedule CA (540 or 540NR), line 36.
2) Franchise tax or income taxes paid by an S corporation	Federal law allows a deduction for franchise taxes or income taxes paid under the Corporation Tax Law. California specifically disallows this deduction.	Add the amount of your federal deduction for franchise taxes paid to the amount on Schedule CA (540 or 540NR), line 36.
3) State, local, and foreign income taxes paid	California does not allow a deduction for state, local, or foreign income taxes paid, including amounts paid for State Disability Insurance (SDI) or Voluntary Plan Disability Insurance (VPDI).	Add the amount of your federal deduction for state, local, and foreign taxes paid to the amount on Schedule CA (540 or 540NR), line 36.
4) Other adjustments	Adjustments to itemized deductions include: adoption related expenses, mortgage interest credit, nontaxable income expense, employee business expense, investment interest expense, gambling losses, federal estate tax, generation skipping transfer tax, prior year charitable contribution carryovers, interest on loans from utility companies, and medical benefits paid on behalf of domestic partners.	See Schedule CA (540 or 540NR), line 39, for more information.