2021 California Personal Income Tax

This course discusses tax law from the Franchise Tax Board's *2020 Personal Income Tax Booklet*, Form 540 for the State of California. This basic tax course is designed for existing tax preparers who currently hold a valid CTEC ID with the California Tax Education Council (CTEC). Upon completion of this course, the student will receive 5 State Hours of continuing education credits in reference to the California Tax Education Council (CTEC).

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NOTICE

This course is presented with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional advice and assumes no liability whatsoever in connection with its use. Since laws are constantly changing, and are subject to differing interpretations, we urge you to do additional research and consult appropriate experts before relying on the information contained in this course to render professional advice

Introduction

For the California quiz and final test questions, you will need to know the information presented below. However, additional information can also be obtained from the *2020 Personal Income Tax Booklet, Form 540*.

The California Personal Income Tax Booklet and information provided at additional links below are not required to be reviewed for the successful completion of this course. Only the reading material provided below and the completion of the California quiz and final test questions with a passing score of 70% or better is required for this course and only these items are factored into the CTEC word count formula to determine the 5 hours of CE credit provided by this course.

Links provided to forms and publications are the most recent available as of the publication date of this course. If you are looking for a previous or future year form, you can go to the following link and search for its availability *California Forms and Publications*.

In general, California usually conforms to federal tax law for tax years on or after January 1, 2015. Note; there are some exceptions to this throughout this reading assignment. In addition, California has not conformed to the latest tax law changes under Tax Cuts and Jobs Act (TCJA)

The California Franchise Tax Board

The tax collection agency for the State of California is the Franchise Tax Board. In many ways, it operates in the same manner as the federal Internal Revenue Service. Just as the Internal Revenue Service is known by its initials, IRS, the Franchise Tax Board can also be referred to by its initials, FTB.

The FTB collects personal state income taxes. The FTB collects income taxes from California residents on their income from all sources. The FTB also collects taxes from non-residents who are taxed on their California-based income.

The FTB also collects corporate income taxes. In addition to income taxes, the FTB levies a franchise tax on businesses for doing business in California. A franchise tax is a tax charged by some states to corporations with a filing obligation in those states. The common feature of a state's franchise tax is that it is not typically based on income. Rather, the typical franchise tax calculation centers on the "net worth" of the taxpayer. In California, a business is responsible for the corporate franchise tax if the corporation or limited liability company, treated as a corporation, is doing business in California. Doing business in California is defined as actively engaging in any transaction in California for the purpose of financial gain or profit. This is discussed in more detail later in this reading assignment. Foreign corporations that are general partners of partnerships or members of limited liability companies (treated as partnerships for tax purposes) doing business in California are also responsible for the corporate franchise tax.

The minimum franchise tax is the amount that must be paid the first quarter of each accounting period whether the corporation is active, operates at a loss, or does not do business. The current minimum tax is $800 (2020 tax year). For new corporations that qualify or incorporate with the Secretary of State, the tax is measured based on their income for the year and subject to estimate requirements. For subsequent years, the minimum tax is $800.

Why is it called the Franchise Tax Board? Now that you know that one of the taxes that the FTB collects is a franchise tax on certain businesses, you can start to guess where the name came from. The FTB's name reflects the fact that it was originally created to collect the franchise tax. In 1879 California adopted its state constitution which among many other programs created the State Board of Equalization and the State Controller, which at the time administered all California tax programs. In 1929, the state legislature created the office of the Franchise Tax Commissioner to administer California’s Bank and Corporation Franchise Tax Act. The agency's name was left unchanged even after the state created a personal income tax and added it to the FTB's responsibilities. And that is where the name comes from.

The FTB also collects delinquent vehicle registration debt collections on behalf of the California Department of Motor Vehicles and delinquent court-ordered debt.

California and the Federal Tax Cuts and Jobs Act
The Tax Cuts and Jobs Act (TCJA) signed into law on December 22, 2017, made changes to the Internal Revenue Code (IRC). In general, California does not conform to the changes. California taxpayers continue to follow the IRC as of the specified date of January 1, 2015, with modifications.

Here is a summary of some of the possibly more significant conformity issues:

Where California Conforms
Medical Expenses California conforms to the temporary reduction of the itemized expense for medical expenses floor of 7.5% of adjusted gross income for all taxpayers that the TCJA and Further Consolidated Appropriates Act implemented for the 2017 through 2020 tax years.
Loophole Closure and Small Business and Working Families Tax Relief Act of 2019 Assembly Bill 91 modified the Earned Income Tax Credit, created the Young Child Tax Credit, disallowed a separate state election for certain qualified stock purchases, and selectively conformed, with modifications, to several federal Tax Cuts and Jobs Act provisions.

In general, for taxable years beginning on or after January 1, 2019, California conforms with modifications to the following TCJA provisions:

- California Achieving a Better Life Experience (ABLE) Program
- Federal Deposit Insurance Corporation (FDIC) Premium
- Excess employee compensation
- Excess business loss

Like-Kind Exchanges California conforms with modifications, under the TCJA for exchanges completed after January 10th, 2019. However, for California purposes, with regard to individuals, this limitation only applies to:

- A taxpayer who is a head of household, a surviving spouse, or spouse filing joint return with adjusted gross income (AGI) of $500,000 or more for the taxable year in which the exchange begins.
- Any other taxpayer filing an individual return with AGI of $250,000 or more for the taxable year in which the exchange begins.

Small Business Method of Accounting Election For taxable years beginning on or after January 1, 2019, California conforms to provisions of the TCJA relating to changes to accounting methods for small businesses. California now conforms to the TCJA's provision that increases the average annual gross receipt limit to $25 million for cash method taxpayers, (this limit was at $5 million prior to the TCJA).

Student Loan Discharged Due to Closure of a For-Profit School California law allows an income exclusion for an eligible individual who is granted a discharge of a student loan due to the closure of a for-profit school, student death, or disability.

Where California does not Conform
Section 179 Expense Under IRC Section 179, businesses that purchase qualifying equipment are typically able to write off the entire amount of that purchase in the year of acquisition. The TCJA provides an increase in the maximum Section 179 expense amount from $500,000 to $1 million, subject to limitations if one puts large amounts of qualifying assets into service. The new law also allows non-residential real property such as roofs, HVAC, fire protection and alarm systems, and security systems that are placed in service after December 31, 2017, to be eligible for the deduction. California does not conform to the changes to Section 179. Instead, California allows a corporate or personal taxpayer to deduct up to $25,000.

Bonus Depreciation The TCJA provides a 100 percent first-year depreciation deduction, an increase from 50 percent under prior law, for certain property placed in service after September 27, 2017. This provision also modifies the type of property that qualifies for this deduction to include the purchases of used equipment, so long as it was purchased in an arms-length transaction. California does not conform to the rules regarding bonus depreciation. Instead, California depreciation is generally deducted under regular tax depreciation methods, or accelerated under Section 179 up to $25,000 as discussed above.

Section 199A Deduction Section 199A deduction is a new 20-percent deduction of certain businesses' qualified business income (QBI) and is taken on an individual's or trust's tax return. Most QBI is reported on a taxpayer's Schedule C where they report business income or Schedule E, which reports rental income and income from K-1s. Individuals may be eligible to take this deduction regardless of whether they itemize deductions reported on Schedule A or take the standard deduction (Note: The standard deduction increased significantly under the new tax law). However, this is only a federal deduction for those that qualify. California does not conform to Section 199A, and therefore the 20-percent QBI deduction cannot be taken against California income.

Limitation for State and Local Taxes California does not conform with the limitation on the itemized expense deduction for state and local taxes enacted by the TCJA. For tax years from 2018 through 2025, the TCJA prohibits individual taxpayers from deducting more than $10,000 in state and local taxes ($5,000 in the case of a married taxpayer filing separately). This limitation only applies to taxes not incurred in a taxpayer's trade or business. California does not have any such limitation on state and local tax deductions.

Unreimbursed Business Expenses Unreimbursed business expenses incurred by an employee for work done for an employer is no longer deductible as an itemized expense (subject to a 2% of AGI limitation) under the TCJA for the tax years 2018 through 2025. California does not conform with this change so for now, employees should continue to keep track of these expenses, save receipts, and determine if they can deduct some of these expenses as California itemized expenses. Note: armed Forces Reservists, qualified performing artist, fee-basis state or local government officials, or employees with impairment-related work expenses, may still itemize this deduction federally (subject to a 2% of AGI limitation).

Deductions for Certain Miscellaneous Expenses The TCJA suspends the deduction for any miscellaneous itemized deductions subject to 2 percent of AGI floor.

These expenses include:

- Investment advisory and management fees
- Fees for legal and tax advice related to investments
- Trustee fees to manage IRAs and other investment accounts, and
- Rental fees for a safe deposit box.

Another miscellaneous expense that could be itemized subject to the 2% rule was tax preparation fees for the completion of a personal tax return. California again has not conformed to the suspension of these items, for now, taxpayers should continue to keep track of these expenses, save receipts, and determine if they can deduct some of these expenses as California itemized expenses.

Alimony Payments Prior to the TCJA, alimony (referred to as "spousal support" by the FTB) was taxable to the individual receiving alimony payments and the person making the alimony payments could deduct the payments from there return as an "above the line" adjustment to income. This was true for both federal and State of California tax returns. However, with the enactment of the TCJA bill, any divorce or separation instruments executed after December 31, 2018 (or modified after that date) will no longer allow a taxpayer paying alimony to deduct the payments from the tax return and the recipient of alimony will no longer be taxed on the payments. California has not conformed to this change and therefore this is another example of added complications for California taxpayers completing both a federal and California return. Adjustments will need to be made for both the payers

and the recipient's California tax return. California continues to conform to federal law regarding child support payments, that are not counted as income to the recipient and can not be deducted as an expense by the payer.

Conclusion, for now... There is one important point that taxpayers and tax preparers need to keep in mind – changes to the IRC will not affect how much Californians pay in state income tax for 2020 and beyond if the State Legislature does not act on any of the TCJA enacted changes. What it will do is make filing tax returns more complicated for some. As an example, those who take the new, higher standard deduction on their federal tax return will still be able to claim itemized deductions on their state return if that will give the taxpayer a higher deduction on their state return. For example, for the state and local tax limitation, California does not conform to this limit as mentioned above. Therefore this could make some taxpayers able to itemize on their state return. Anything that was deductible on a state return last year is still deductible, and state tax rates have not changed. This will continue to be true unless the State Legislature takes some kind of action concerning state taxes. Because of this, it is important that tax preparers continue to make sure that their clients continue to keep records of expenses that could potentially still be deductible of their state return.

California Personal Tax Return Forms

California Tax Forms

California has several personal income tax returns and the return filed depends primarily on the taxpayer's income, types of income adjustments, eligible credits, and residency status. The following is a recap of each type of "540" return.

Form 540, California Resident Income Tax Return is the most complete version of the state's individual resident income tax return. Before starting and to complete Form 540 for the individual, you must complete their federal income tax return.

Form 540 2EZ is a simplified California state tax form for residents who meet certain filing requirements. The circumstances where you can file a Form 540 2EZ will be covered below.

Form 540NR can be only completed by part-year and nonresidents of California after they have completed their federal income tax return because they will need to include information from their federal income tax return on Form 540NR.

As a tax preparer you should always start with the complete version of the tax return. For California that is Form 540. This ensures that nothing will be missed that could impact the taxpayer's tax liability.

California Residents

Which "540" tax form should be used? Again, it is always best to use the complete form as you start interviewing a taxpayer. However, once you have determined that the complete version of Form 540 is not necessary.

You can use Form 540 2EZ under the following circumstances:

- The filing status is single, married/Register Domestic Partner (RDP) filing jointly, head of household, or qualifying widow(er) – in other words, one cannot use the married/RDP filing separate status
- They have 0-3 dependents
- Their taxable income is: $100,000 or less (single or head of household) $200,000 or less (married/RDP filing jointly or qualifying widow(er))
- Their income is from:
    - Wages, salaries, and tips.
    - Taxable interest, dividends, and pensions (excluding IRA distributions or conversions).
    - Capital gains from mutual funds (on Form 1099-DIV, Box 2a).
    - Taxable scholarship and fellowship grants (only if reported on Form W-2)
    - Unemployment
    - Paid Family Leave Insurance
    - U.S. Social Security. Tier 1 and tier 2 railroad retirement payments
- They do not have adjustments to total income such as student loan interest deduction, IRA deduction, etc.
- They are using standard deductions – no itemized deductions
- Their payments are only California income tax withheld shown on Form(s) W-2 and 1099-R
- Their exemptions are Personal exemptions, Senior exemptions, or up to three dependent exemptions
- Their only credit is the Nonrefundable Renter's Credit

Generally, if the taxpayer and spouse can be claimed as a dependent by another taxpayer they will not be able to use Form 540 2EZ. All other situations will require them to file Form 540.

Nonresidents or Part-Year Residents

The Short Form 540NR has been eliminated as of January 1st, 2019. Therefore the Long Form 540NR was renamed to Form 540NR, California Nonresident or Part-Year Resident Income Tax Return.

Completion of the California Tax Return

All tax returns are required to be signed by the taxpayer and spouse/RDP (if Married/RDP Filing Joint) in the space provided on California Form 540. Requirements for signing with a power of attorney, for a deceased taxpayer, or for a surviving spouse are the same as on the federal return. If the taxpayer wishes to designate a power of attorney, they may use FTB Form 3520. In general, the power of attorney will remain in effect until it is revoked. The designee may sign the taxpayer's return, receive notices, and aid in tax-related issues for the taxpayer. Beginning January 2, 2013, the revised FTB Form 3520 no longer allows joint filers to sign and file the same power of attorney form. Now, joint filers must submit a separate FTB Form 3520 for each spouse/RDP, in keeping with federal procedures. The taxpayer may also use the federal *Form 2848, Power of Attorney and Declaration of Representative*, handwritten authority documents, and general or durable power of attorney declarations (subject to FTB review). Federal Form 2848, may be used however, it must be modified to include California FTB matters. For this reason, it is recommended that FTB Form 3520 be used.

Filing a California Tax Return

E-File
California personal income tax returns can be e-filed directly with the FTB through the CalFile program. A taxpayer must set-up an account with CalFile in order to use the service. This service is provided at no charge. There are also other free and fee-based services that will electronically file a taxpayer's tax return.
Tax Preparers can also participate in the California Individual E-File Program which will allow the tax preparer to e-file the client's tax returns. The program provides many advantages to the filer. CalFile provides a proof of receipt acknowledging that a return has been accepted for further processing. If errors are detected with a filed return, then the CalFile system will inform the tax preparer and provide an opportunity to correct the return. This can avoid subsequent notices to clients or even the possible need to file Schedule X. Using CalFile also ensures that the electronic filing process is safe. CalFile uses the latest technologies to ensure the security and privacy of all taxpayer information. All returns are received via secure internet transmission. CalFile provides year-round electronic return filing – the individual e-file system is available year-round. Usually, up to the previous two years of past-due tax returns can be e-filed, along with current tax year returns.

California E-File Program Enrollment Requirements for Tax Preparers
The process for preparing and submitting an e-file return is very similar to the paper return process. The taxpayer's tax return is completed as a paper return normally would be. The taxpayer is provided with a copy of their tax return and a California E-File Return Authorization for Individuals FTB Form 8453. There is an alternate FTB Form 8879 that can be used when the Practitioner PIN method is used and the taxpayer's shared secret is not known or the taxpayer cannot physically enter their PIN on their Electronic Return Originator's (ERO's) computer.
If there are any errors and the return is rejected by the FTB, the tax preparer must correct and resubmit the return as quickly as possible, normally within 48 hours is acceptable. The reject acknowledgment will provide information regarding the error, including the error itself, form or schedule impacted, and occurrence number for multi-page forms and schedules. The return is not considered filed until the FTB issues an acknowledgment to the tax preparer. Once the return is acknowledged, the date the return was accepted is entered on FTB Form 8453 or FTB Form 8879. The paid tax preparer can also be the Electronic Return Originator (ERO). If the ERO is also the paid preparer, the ERO must check the box labeled "Check if also paid preparer" on FTB Form 8453. If the ERO is not the paid preparer, the paid preparer must sign in the space for "Paid preparer must sign."
The ERO is responsible for signing the FTB Form 8453 or 8879 and providing the taxpayer with copies of all W-2s, W-2Gs, and 1099Rs. The taxpayer must also be provided with a copy of the filed tax return including all forms and schedules associated with the return. The original or fax of the FTB Form 8453 or 8879 must be retained by the ERO for a period of four years from the due date of the return or the date the return was filed, whichever is later.

When e-filing a tax return some common errors to be aware of so that they can be avoided and help reduce rejected returns includes the following:

- Form W-2 withholding does not equal the amount shown on the return. Remember to compare the amount of withholding on the return to the total of the amounts shown on Form W-2. The amounts should match.
- When using the Electronic Signature (PIN) the taxpayer's prior year AGI does not match FTB Records. Double-check the taxpayer's prior year AGI from last year's CA tax return or sign the e-file return using FTB Form 8453/8453-OL.
- Taxpayer SSN or Spouse SSN has been previously used on an e-filed return. This usually happens when the electronically filed federal return is rejected but the California return has

been accepted. This is a common occurrence so make sure not to retransmit an accepted California return when retransmitting a corrected federal return.

Mandatory E-File of Individual Tax Returns California tax law requires individual income tax returns prepared by certain income tax preparers to be electronically filed. Tax preparers who prepare more than 100 California individual income tax returns annually and prepare one or more using tax preparation software are required to e-file all personal income tax returns.
Paper Filed Tax Return California will still accept a paper filed tax return. Staple copy 2 of Forms W-2 and W-2G to page one of the return. Also staple any 1099s, 592-Bs, and 593s that show California withholdings. A copy of the federal tax return must be attached behind the state return if the federal return Form 1040 has any forms or schedules other than Schedules A or B attached to it.
The taxpayer may request a copy of their California Tax Return up to 3 ½ years after the original due date by either walking into any local FTB office and verbally requesting a copy, writing a letter to the Franchise Tax Board requesting the copy, or by completing FTB Form 3516.

Schedule X Amended Individual Income
If a tax preparer discovers a need to amend an individual's return because of an error or omission from the original return, you may file California Schedule X. If the taxpayer is making a claim for a refund, the amended return must be filed within one year from the date of overpayment of tax or within four years from the original due date of the return (usually April 15th), whichever time period expires later. The tax preparer will then attach any California state forms and schedules that were affected by the changes made on Schedule X. They will also attach a complete copy of the federal amended tax return Form 1040X and the federal forms and schedules affected by it.
If the taxpayer's AGI changed due to notification from the IRS of an error on the federal income tax return, then you may need to amend their California income tax return for the corresponding year. Changes must be reported to the FTB within six months if the IRS evaluates and changes the taxpayer's federal income tax return, and finds that they owe additional tax. If the changes made by the IRS do not affect the taxpayer's California tax liability, the taxpayer is not obligated to inform the FTB. If applicable, a copy of the final federal determination must be included, along with all supporting data, forms, and schedules that explain the federal adjustment. Most penalties imposed by the IRS also apply under California law. If the taxpayer is including penalties in a payment with the amended return, the amount of the penalties should be entered on line 8 of Schedule X. A statement including detailed information for each penalty and a schedule showing how each was computed must be attached to Schedule X. Schedule X cannot be filed electronically. It must be mailed to the address on the form. If you are filing the taxpayer's amended tax return after the normal statute of the limitation period which is four years after the due date of the original tax return, attach a statement explaining why the normal statute of limitations does not apply.

Deceased Taxpayer
The final California return for a deceased taxpayer is due on April 15th following the end of the calendar year the death occurred, the same as for federal. If a return would normally be required, a final return must be filed for the deceased taxpayer. The administrator, executor, or beneficiary is responsible for filing the return and making sure that any tax due is paid. The word "Deceased" and the date of death should be printed next to the taxpayer's name on the final return. If there is a surviving spouse/RDP and there was no administrator or executor appointed, the surviving spouse/RDP should file a joint return if they did not remarry or enter into another registered domestic partnership during the tax year. The surviving spouse/RDP would sign the return as usual and follow their signature with "Surviving Spouse/RDP".
If there was an administrator or executor appointed, the surviving spouse/RDP may still file a joint return; however, the administrator or executor will act on behalf of the deceased taxpayer. They must sign the return that is filed for the decedent. The surviving spouse must sign the return if a joint return

is filed. For an estate or trust, the return must be filed within 3½ months after the close of the month in which the estate or trust was terminated, the same as for federal.

Power of Attorney

If another person prepared one's tax return, they are not automatically granted access to the taxpayer's tax information in future dealings with the FTB. At some point, the taxpayer may wish to designate someone to act on their behalf in matters related or unrelated to a filed tax return (e.g., an audit examination). To protect their privacy, they must submit to the FTB a legal document called a Power of Attorney (POA) authorizing another person to discuss or receive personal information about their income tax records. More information can be obtained by reviewing FTB Form 3520, Power of Attorney Declaration.

California Tax Filing Requirements

A taxpayer must file a California income tax return if either their California gross income or their California adjusted gross income was more than the amount shown below for filing status, age, and number of dependents (table taken directly from California tax publication). Even if a return is not required to be filed based on the below a return should be filed in order to get a refund if California state income tax was withheld from pay, or if California estimated tax payments were made.

Filing Status	Age as of December 31, 2020*	California Gross Income			California Adjusted Gross Income		
		Dependents			Dependents		
		0	1	2 or more	0	1	2 or more
Single or head of household	Under 65	$18,496	$31,263	$40,838	$14,797	$27,564	$37,139
	65 or older	$24,696	$34,271	$41,931	$20,997	$30,572	$38,232
Married/RDP filing jointly or separately	Under 65 (both spouses/RDPs)	$36,996	$49,763	$59,338	$29,599	$42,366	$51,941
	65 or older (one spouse)	$43,196	$52,771	$60,431	$35,799	$45,374	$53,034
	65 or older (both spouses/RDPs)	$49,396	$58,971	$66,631	$41,999	$51,574	$59,234
Qualifying widow(er)	Under 65	N/A	$31,263	$40,838	N/A	$27,564	$37,139
	65 or older	N/A	$34,271	$41,931	N/A	$30,572	$38,232
Dependent of another person (Any filing status)	Under 65	More than your standard deduction					
	65 or older	More than your standard deduction					

** If the taxpayer turns 65 on January 1, 2021, they are considered to be age 65 at the end of 2020.*

Income Tax Table Rates

The Franchise Tax Board provides a table to assist taxpayers in calculating their California State tax liability. This table covers taxable income amounts from $1 to $100,000 and will provide the individual with their tax liability according to their income. The tax rate tables are available at this link. There will be quiz questions related to looking up tax dues that will be taken from the tax tables. You will need to access the table from the link to answer questions specific to tax liability.

Exemption Credits

Exemption credits reduce California tax liability. In California, there are four types of exemption credits:

1. Personal Exemptions $124 – allowed per taxpayer. If the taxpayer has a spouse/RDP both are entitled to an exemption for a total of $248.
2. Blind Exemptions $124 - allowed for the taxpayer and/or his spouse/RDP if either or both are visually impaired. The affected individual is considered visually impaired if he is not capable of seeing better than 20/200 while wearing corrective eyewear or if the field is vision is not more than 20 degrees.
3. Senior Exemptions $124 – allowed for the taxpayer and/or his spouse/RDP who is 65 years of age or older by January 1, 2021.
4. Dependent Exemptions $383 – allowed for taxpayers who have dependents listed on their tax return.

To claim an exemption credit for each dependent, write each dependent's first and last name, social security number, and relationship to the taxpayer in the space provided on Form 540. If claiming more than three dependents, attach a statement with the required dependent information to the tax return. Count the number of dependents listed and enter the total in the box on line 10. Multiply the number you entered by the pre-printed dollar amount and enter the result. Add line 7 through line 10 and enter the total dollar amount of all exemptions for personal, blind, senior, and dependent categories. If the federal adjusted gross income (AGI) on line 13 is more than the amount shown below for the filing status, the credits will be limited. For purposes of computing limitations based upon AGI, RDPs recalculate their AGI using a federal pro forma or California RDP Adjustments Worksheet (located in FTB Publication 737 – will not be reviewed here). If the recalculated federal AGI is more than the amount shown below for the filing status, the exemption credits will be limited.

If the taxpayer's filing status is: If line 13 more than:

Single or married/RDP filing separately	**$203,341**
Married/RDP filing jointly or qualifying widow(er)	$406,687
Head of household	$305,016

Exemption credit phase-out calculation:

Filing status	**Reduce each credit by:**	**For each:**	**Federal AGI exceeds:**
Single	$6	$2,500	$203,341
Married/RDP filing separately	$6	$1,250	$203,341
Head of household	$6	$2,500	$305,016
Married/RDP filing jointly	$12	$2,500	$406,687
Qualifying widow(er)	$12	$2,500	$406,687

Example A single filer taxpayer has reported a Federal AGI of $208,341. She has exceeded the exemption credit phase-out start limit by $5,000. Her exemption credit will be reduced by $12.00 for a reduced exemption credit of $102.00

In order to calculate the California exemption credit percentage for a California part-year resident, the taxpayer will divide the California taxable income by total taxable income on line 38 of Form 540NR.

Standard and Itemized Deductions

Standard Deductions
Just like on the federal return, a taxpayer has the option to itemize or take a standard deduction. In addition, a taxpayer can itemize on the California return even if the federal return did not have itemized deductions. The taxpayer will pay less in taxes if they take the larger of the California itemized deductions or the California standard deduction. If the taxpayer is married and files a separate return, both spouses must either itemize or use the standard deduction, one cannot use one method and the other another method if filing a married filing separate return.
The 2020 Tax Year California Standard Deduction Chart for Most People
Do not use this chart (taken directly from the California 540 tax publication) if the taxpayer's parent, or someone else, can claim them (or their spouse/RDP) as a dependent on their tax return.

The Filing Status

Single	**$4,601**
Married/RDP filing jointly	$9,202
Married/RDP filing separately	$4,601
Head of household	$9,202
Qualifying widow(er)	$9,202

The minimum standard deduction for dependents is $1,100
On federal tax returns, individual taxpayers who claim the standard deduction are allowed an additional deduction for net disaster losses. For California, deductions for disaster losses are only allowed for those individual taxpayers who itemized their deductions.
California standard deduction amounts are less than federal amounts. Because of this, it may be to the taxpayer's advantage to itemize on the California return even though they did not itemize on the federal return.

Itemized Deductions
The 2020 Tax Year, California Itemized Deduction Limitations
(Taken directly from the California 540 tax publication):

Single or married/RDP filing separately	**$203,341**
Head of household	$305,016
Married/RDP filing jointly or qualifying widow(er)	$406,687

RDPs use their recalculated federal AGI to figure itemized deductions by completing Schedule CA (540), Part II, line 38 through line 44. Enter the result on Form 540, line 18. California itemized deductions may be limited based on federal AGI. To compute the standard deduction or the California amount of itemized deductions, the last section of Schedule CA (540) is used. You may review the schedule at the link provided so that you can become more familiar with the schedule. If deductions were not itemized on the federal income tax return but will be itemized for California, first complete federal Schedule A (Form 1040), Itemized Deductions. Then complete Schedule CA (540), Part II, line 38 through line 44. Attach both the federal Schedule A (Form 1040) and California Schedule CA (540) to the back of the tax return.

State, Local, and Foreign Income Taxes
Unlike federal tax law, California does not allow the deduction of any state, local, or foreign income tax or the deduction of State Disability Insurance(SDI) or Voluntary Plan for Disability Insurance (VPDI). These would have been listed on the federal Schedule A, line 5 (Form 1040) and only the portion

relating to foreign income taxes from line 8. Included on line 5 of the federal Schedule A should be state and local income tax and SDI, limited partnership tax and income or franchise tax paid by S corporations (if applicable); or state and local general sales tax. The preparer should also include any amounts paid to California during the tax year for estimated tax payments or as a result of a balance due for a prior tax year. An adjustment should be made on Schedule CA (540), Part II, line 39 to remove the following amounts from the California itemized deductions:

- *Schedule A*, line 5, state and local income tax (including limited partnership tax and income or franchise tax paid by corporations), and State Disability Insurance (SDI), or state and local general sales tax.
- *Schedule A*, line 8, foreign income taxes.

Personal Property Taxes and Real Estate Taxes

On both federal and state returns both are deductible.

Medical and Dental Expenses

Deduction Beginning with the tax year 2013 through 2016, federal law changed the 7.5% AGI limit previously required before medical and dental expenses could be deducted (for taxpayers under the age of 65). Taxpayers could only deduct medical and dental expenses when the expenses exceeded 10% of federal AGI. California did not conform to that federal increased threshold percentage. Instead, California continued to allow a deduction for medical and dental expenses exceeding 7.5% of federal AGI for all taxpayers. Because of the difference from 2013 to 2016, taxpayers under age 65 needed to calculate the itemized medical and dental expense deduction separately for California and federal and the difference between the two was then entered as an adjustment item on Schedule CA (540). There is good news for 2017 and 2018, the federal tax has once again reverted back to the 7.5% AGI threshold for all taxpayers (part of the Tax Cuts and Jobs Act). Therefore for 2017 and 2018 tax year filers, there was no adjustment if medical and dental expenses are itemized. For the 2019 and 2020 tax year, medical and dental expenses exceeding 7.5 of federal AGI remain the same federally, and therefore, as mentioned previously California currently conforms with the TCJA.

Health savings account (HSA) payments used for medical expenses are not included in federal itemized deductions. For California purposes, if the taxpayer received a distribution from an HSA to pay for qualified medical expenses, the qualified expenses paid are included when calculating the medical and dental itemized expense deduction for the California tax return. Therefore, an itemized deduction adjustment must be figured by separately calculating the California and federal amounts for medical and dental expenses. This is because, in California, HSA contributions are not tax-deductible. The difference between the two should be entered as a positive number on Schedule CA (540), Part II, line 4.

Adoption-Related Expenses

If the taxpayer deducted adoption-related expenses on their federal Schedule A and is claiming the adoption credit using those same amounts on their California tax return, the requirements for the California credit are more restrictive. These restrictions include that they can only claim the California credit if the child is a U.S. citizen and was adopted from a California public agency (state, county, or city). Private adoptions and adoptions through a charitable organization do not qualify for the credit.

Private Mortgage Insurance (PMI)

Private Mortgage Insurance is a type of insurance policy provided by a private company to homeowners to protect lenders against a loss if the borrower (homeowner) defaults. California law does not conform to the federal provision for the deduction of PMI. Subtract the same amount of federal private mortgage interest which was deducted on federal Schedule A, on Schedule CA (540) Part II, line 41 (a negative number).

Investment Interest Expense
Generally, California law conforms to federal law regarding this deduction. However, due to California allowing taxpayers to make a separate election to include net capital gain investment income when calculating the investment interest limitation, the California deduction for investment interest expense may be different from the federal deduction. The effect on California tax should be considered before making a separate California election. Taxpayers should use Form FTB 3526, Investment Interest Expense Deduction, to figure the amount to enter on Schedule CA (540), line 41.

Qualified Charitable Contributions
The taxpayer's California deduction may be different from their federal deduction. The California deduction is limited to 50% of the taxpayer's federal adjusted gross income. The taxpayer will need to figure separately, the amount allowed using federal law and the amount allowed using California law. The difference should be entered as a negative number on line 41 of Schedule CA (540), Part II, Charitable Contribution Carryover Deduction. If the taxpayer is deducting a prior year charitable contribution carryover, and the California carryover is greater than the federal carryover (from federal Schedule A, line 18), the taxpayer will need to increase the California itemized deductions by entering the additional amount as a positive number on Schedule CA (540), Part II, line 41.

For taxable years beginning on or after January 1, 2014, California law disallows a charitable contribution deduction to an educational organization that is:

- A postsecondary institution
- To the Key Worldwide Foundation

Employee Business Expenses
As previously discussed taxpayers, with the exception of armed forces reservists, qualified performing artists, and fee-basis state or local government officials, can no longer use IRS Form 2106 or IRS Form 2106E-Z Employee Business Expenses to report and deduct employee business expenses on their federal return. This is due to the recent change under the TCJA that disallows deducting employee expenses as an itemized deduction. California, however, does not conform to this change and will still allow the unreimbursed expenses to be deducted as an itemized deduction on the state return.
When claiming California employee expenses the taxpayer will need to prepare a separate pro forma federal IRS Form 2106 or IRS 2106-EZ following California law to determine their employee business expenses using California amounts. Generally, California law conforms to federal law in regards to what is considered an employee business expense.

However, differences occur when:

- Assets (requiring depreciation) were placed in service before January 1, 1987 Figure the depreciation based on California law
- Federal employees were on temporary duty status California does not conform to the federal provision that expanded temporary duties to include prosecution duties, in addition to investigative duties. Therefore, travel expenses paid or incurred in connection with temporary duty status (exceeding one year), involving the prosecution (or support of the prosecution) of a federal crime, should not be included in the California amount

The taxpayer that qualifies to file IRS Form 2106 should compare federal IRS Form 2106, line 10, or IRS Form 2106-EZ line 6, against the pro-forma federal form completed using California amounts. If the California amount is larger, the taxpayer will enter the difference as a positive number on line 41 of Schedule CA (540). If the federal amount is larger, the taxpayer will enter the difference as a negative number on line 41.

Nontaxable Income Expenses

Expenses claimed by the taxpayer on federal Schedule A directly related to the production of income taxed under federal law, but not taxed by California must be added back to federal itemized deductions (line 38) for California purposes. The amount from Schedule A will be entered as a negative number on line 41 of Schedule CA (540), Part II. Conversely, expenses related to the production of income taxed by California law but not taxed under federal law can be claimed by the taxpayer. They will enter the amount as a positive number on line 41 of Schedule CA (540), Part II.

Federal Estate Tax

Federal estate tax paid on income in respect of a decedent is not deductible for California. Enter the amount of federal estate tax shown on federal Schedule A (Form 1040) as a negative number on Schedule CA (540), Part II, line 41.

Generation-Skipping Transfer Tax (GSTT)

The generation-skipping transfer tax is a federal tax on the transfer of property by gift or inheritance to a beneficiary who is at least 37½ years younger than the donor. Under California law, tax paid on generation-skipping transfers (GSTT) is not deductible. Since it is deductible on federal Schedule A, the amount of tax deducted on federal Schedule A must be subtracted when figuring California itemized deductions and entered as a negative number on Schedule CA (540), Part II, line 41.

California Adjusted Gross Income (CA AGI)

California like most other states generally taxes income the same as the federal. For this reason, California starts the tax calculation with the federal AGI, then subtracts and adds adjustments to arrive at the California AGI. Adjustments to federal income are made on Schedule CA (540). The purpose of this schedule is to use California law in making adjustments to federal adjusted gross income and to federal itemized deductions.
Some of the more common adjustments include (these will be discussed in more detail in Form CA(540) California Adjustments section later on in this reading assignment) include the following:

Non-taxable State Subtractions:

- Interest on US obligations
- Dividends received on US or California/Local obligations
- Interest from U.S Saving Bonds
- State tax refunds
- Unemployment Compensation
- Paid Family Leave (PFL)
- Social Security benefits/Railroad Retirement Tier 1 benefits
- California lottery winnings
- State Disability Insurance
- General Sales Tax

Taxable Additions:

- Interest on Non-California State municipal obligations enter on Schedule CA column C
- Dividends on Non-California State municipal obligations
- Certain HSA contributions (discussed in a later chapter)
- Certain Foreign Source Income
- Alimony received by a non-resident alien and not included in the taxpayer’s federal income

California gross income is all income one received in the form of money, goods, property, and services from all sources that are not exempt from tax. Gross income does not include any adjustments or deductions. California adjusted gross income is the taxpayer's federal adjusted gross income from all sources reduced or increased by all California income adjustments. Subtractions to AGI are entered on line 14 of Form 540 and additions are entered on line 16 of Form 540. Once adjustments are made, California AGI is entered on line 17 of Form 540. Schedule CA (540) is used to record the specific additions and subtractions and is filed with Form 540.
Links to both forms are provided below and it is suggested that you review both to become familiar with these two forms, which will probably be the two most common forms that you will complete and file for California taxes.

California Form 540 (CA) California Adjustments
California Form 540 California Resident Income Tax Return

Adjusting the federal income amounts to California amounts is done on Schedule CA (540). The lines 10-22 even correspond to the federal Schedule 1 lines. Amounts from the federal return are entered in column A. California subtractions are entered in column B. California additions are entered in column C. All columns are then totaled and carried forward to Section B (Adjustments to Income), where federal adjustments to income are reconciled with California tax law, using the same 3 column format.

Registered Domestic Partners (RDPs) who file a California tax return as married/RDP filing jointly and have no RDP adjustments between federal and California, combine their individual AGIs from their federal tax returns filed with the IRS. Enter the combined AGI on Form 540, line 13.

RDP adjustments include but are not limited to the following:

- Division of community property
- Transfer of property between RDPs
- Capital loss
- Transactions between RDPs
- Sale of residence
- Dependent care assistance
- Investment interest
- Qualified residence interest acquisition loan & equity loan
- Expense depreciation property limits
- Individual Retirement Account
- Education loan interest
- Rental real estate passive loss

RDPs filing as married/RDP filing separately, former RDPs filing separately, and RDPs with RDP adjustments will use the California RDP Adjustments Worksheet in FTB Publication 737, Tax Information for Registered Domestic Partners, or complete a federal pro forma Form 1040. Transfer the amount from the California RDP Adjustments Worksheet, line 37, column D, or federal pro forma Form 1040, line 8b, to Form 540, line 13. For tax years prior to 2013, same-sex married individuals were not recognized as married for federal income tax purposes and therefore, had to adhere to the same filing rules as RDPs and adjust to California tax law differences accordingly. Effective September 16, 2013, IRS Revenue Ruling 2013-17 recognizes same-sex marriages for federal income tax purposes in certain instances. The IRS looks to state and foreign law to determine whether a marriage is valid. So, beginning with the tax year 2013, same-sex spouses generally must now file their federal returns using a married filing separately or jointly filing status.
Taxable Income California differs a little from federal when arriving at taxable income. Like the federal, California allows the deduction of the greater, itemized or standard deductions.

It does not allow a deduction for:

- *Personal Exemptions* In California, exemptions are non-refundable tax credits and not deductions from taxable income
- *Additional Standard Deductions for Age and Blindness* California provides an additional personal exemption for seniors and blindness
- *Higher Standard Deduction Amounts that the Federal Allows* California has a much lower standard deduction for each filing status. See the California standard deduction table earlier in this reading assignment

Children with Investment Income

Kiddie Tax

For taxable years beginning on or after January 1, 2010, California law conforms to federal law which allows parents' election to report a child's interest and dividend income from children under age 19 or a student under age 24 on their tax return. For the 2020 tax year, each child under age 19 or student under age 24 who received more than $2,200 of investment income in 2020, generally must complete FTB Form 540 and Form FTB 3800, Tax Computation for Certain Children with Investment Income, and figures the tax on a separate FTB Form 540 for the taxpayer's child. The tax on minors is sometimes referred to as the Kiddie Tax.

The *Kiddie Tax* was designed to keep parents from shifting investment income to their children to take advantage of the child's lower tax bracket. This resulted in lower taxes for the family as a group since the children usually were in a lower tax bracket then the parents.

The *Kiddie Tax* applies only to unearned income. Unearned income is a child's total income less any earned income such as from a job. Examples of unearned income include income that comes from investments such as interest, dividends, and capital-gain distributions.

Some children are not subject to the Kiddie Tax. A few of the reasons a child would not be subject to the Kiddie Tax are:

- Children not required to file a return because they did not have enough income to report
- Children who earned more than half of their required support. This also means that they are not likely to be a dependent of someone else
- Anyone who files a married filing jointly tax return

Child Reporting Investment Income

As mentioned above for every child under age 19 or student under age 24 who received more than $2,200 of investment income in 2020 Form 540 and Form FTB 3800, Tax Computation for Certain Children with Investment Income, should be completed to figure the tax on a separate Form 540 for the taxpayer's child. Investment income over $2,200 is taxed at the parent's rate if it is a higher rate than the child's rate.

If the child reported their investment income on the federal return Form 1040, line(s) 2 and/or 3, using IRS Form 8615 Tax for Certain Children Who Have Unearned Income, only income taxable by California will be entered on FTB Form 3800. In most cases, the federal amount will be the same as the California investment income amount. Any investment income federally tax-exempt, but not taxexempt by California law, shall be included on FTB Form 3800. In addition, an adjustment will be necessary on Schedule CA (540) for the difference. If the child did not report their investment income on a federal return (because his parents reported the income on their tax return) but chose to report their investment income on the California return, they will need to file FTB Form 3800 if their investment income exceeded $2,000. In any case, the child will need to file Form 540 to report the income along with Schedule CA (540) to adjust for the federal amount that was not reported. The child would enter his investment income on Schedule CA (540), line(s) 8 and/or 9, column C. The tax computation figured on FTB Form 3800 must be entered on line 31 of Form 540 with the FTB 3800 box checked.

Since the child's parents would not be reporting the investment income on their California return, their income would need to be adjusted on Schedule CA (540), line 21f, column B, by the amount of the child's investment income they reported on their federal return. If FTB Form 3800 is not required to be filed by the child, the tax should be figured on the child's tax return (Form 540 or Form 540NR) in the normal manner.

Parents Reporting of Child's Investment Income

If the taxpayer qualifies they may elect to report their child's income of less than $10,000 (but not less than $1,000) on his tax return by completing FTB Form 3803, Parents' Election to Report Child's

Interest and Dividends. To make this election, the child's income must be only from interest and/or dividends. The child must have been under age 19 or a student under age 24 at the end of the tax year. A separate FTB Form 3803 must be used for each child whose income the taxpayer elects to report. The parent with the higher taxable income qualifies to make the election if the taxpayer and the child's other parent lived together, but was unmarried or not RDPs during the tax year. If the taxpayer elected to report his child's investment income on the federal return using Form 8814 Parents' Election To Report Child's Interest and Dividends and also elects to report his child's investment income in his California return, they will need to adjust the investment income amount by differences between the federal and state tax law on what is taxable versus tax-exempt. FTB Form 3803, line 1a is for reporting the taxable interest and line 1b is for reporting the tax-exempt interest. In addition, an adjustment will be necessary on Schedule CA (540) for the difference. If the taxpayer did not elect to report his child's investment income on the federal return because a separate return was filed for the child to report his income, but they choose to report their child's investment income on their California state return, they will need to file FTB Form 3803 to figure out the additional tax that must be entered on line 31 of Form 540 with the "FTB 3803" box checked. On Schedule CA (540), adjustments must be made to account for the increase in investment income and reported on line 21f, column C. The tax computation figured on FTB Form 3803 must be entered on line 31 of Form 540 with the "FTB 3803" box checked.

Payment of California Income Tax

Estimated Tax Payments

California estimated tax payments are due on the same dates as the federal estimated taxes. California requires taxpayers to make estimated tax payments using Form 540-ES if the taxpayer expects to owe at least $500 ($250 if married/RDP filing separately) in tax for 2020 (after subtracting withholding and credits).

California does not conform to federal law in regard to the amounts to pay with each installment. California taxpayers are required to pay 30% of the required annual payment for the 1st required installment, 40% of the required annual payment for the 2nd required installment; no payment is required for the 3rd installment, and 30% of the required annual payment for the 4th required installment.

If at least two-thirds of one's gross income is from farming or fishing, they only have one estimated tax payment due date and the due dates for the first three payment periods do not apply.

The estimated tax payment must be the smaller of:

- 66 ⅔% (rather than 90%) of their current year tax
- 100% of the tax shown on their prior-year return

For calendar year filers, quarterly installments are due on April 15, June 15, September 15, and January 15. The fourth estimate payment due January 15th can be filed with the tax return by January 31st. If the 2020 tax return is filed by January 31, 2021, and the entire balance due is paid, the last estimated tax payment does not have to be made. In addition, the taxpayer will not owe a penalty for the late payment of the fourth installment. For fiscal year filers, the first and second installments are due by the 15th day of the fourth month and the 15th day of the sixth month of the taxable year, respectively. The third installment due date is the 15th day of the ninth month of the taxable year, although no payment is required. The fourth installment is due by the 15th day of the first month following the end of the taxable year. If the 15th is on a Saturday, Sunday, or legal holiday, then the due date is moved to the next day that is not a Saturday, Sunday, or legal holiday.

For the 2021 tax year, the due dates for estimated taxes are as follows:

- January 15, 2021
- April 15, 2021
- June 15, 2021
- September 15, 2021
- January 18, 2022

If the taxpayer qualifies, farmers and fishermen can choose to pay all their estimated payments on January 15th or file and pay their tax by March 1st to avoid paying any underpayment of estimated tax penalties.

It is important to pay estimated taxes if they are required because there are penalties. The taxpayer may owe a penalty if they owe $500 ($250 if married/RDP filing separately) or more, or 10% or more of the tax liability and they underpaid their estimated tax liability for any payment period. To calculate the penalty, use Form FTB 5805, Underpayment of Tax by Individuals and Fiduciaries this form will not be reviewed here. To avoid paying underpayment penalties the taxpayer should adjust their withholding or pay estimated tax payments throughout the tax year. Any penalty imposed is computed as a percentage of the underpayment for the period of the underpayment. The penalty rate and interest rate for refunds and deficiencies are both established semi-annually and identical except that the interest rate is compounded and the penalty rate is not.

Estimated tax payments can be made if the taxpayer expects to owe tax on this income by using Form 540-ES, Estimated Tax for Individuals. If the taxpayer also received Form(s) 1099 showing California

backup withholding (explained below) of taxes withheld, this will also be added to the state taxes withheld. California requires taxpayers to make estimated tax payments if the taxpayer expects to owe at least $500 ($250 if married/RDP filing separately) in tax for 2020 (after subtracting withholding and credits). This topic was also discussed previously in this reading assignment.

State Taxes Withheld

California state withholding is a prepayment of California state income or franchise tax. The total California income tax withheld from a taxpayer is found on the following forms: Form(s) W-2, Box 17; Form(s) W-2G, Box 14; Form(s) 1099-MISC, Box 16; Form(s) 1099-R, Box 12.

California state tax is actually called a "franchise" tax. "As a reminder, FTB" stands for Franchise Tax Board, the name of the state agency that levies and collects California state taxes.

Backup Withholding

Taxpayers who are required to remit backup withholding to the IRS are also required to remit backup withholding to the FTB unless specifically excluded for California purposes. Payer's withhold and remit backup withholding using FTB Form 592-V. The payer is the person or organization that pays an income item or makes a distribution to a taxpayer (also referred to as the "payee"). Backup withholding replaces all other types of withholding for an income item where both backup and other types of withholding apply.

Extension of Time to File

California allows an automatic six-month extension without written request if the taxpayer cannot file his return by April 15th and does not owe taxes for the year. To qualify for an automatic extension, the taxpayer must file his return by October 15th. If the taxpayer owes taxes and cannot meet the April 15th deadline then they will need to complete Form FTB 3519, Payment for Automatic Extension for Individuals, for the automatic six-month extension. An extension of time to file the return is not an extension of time to pay the tax. To avoid late payment penalties and interest, the taxpayer must pay 100% of his tax liability by April 15th. If the taxpayer is living or traveling outside the United States on April 15th, the deadline to file the return and pay the tax is June 15th. Interest will accrue from the original due date, April 15th, until the date of payment. If additional time is needed to file the return, an automatic six-month extension will be allowed without filing a request. To qualify for the automatic extension, the return must be filed no later than December 15th. To avoid late-payment penalties, 100% of the liability must be paid June 15th. When the taxpayer files the return they should write at the top of the front page of his tax return in red ink, "Outside the USA on April 15, 20XX". If the 15th is on a Saturday, Sunday, or legal holiday, then the due date is moved to the next day that is not a Saturday, Sunday, or legal holiday.

Installment Agreements

If an individual is financially unable to pay their tax liability in full, they may be eligible to make payments in installments over time.

An individual may be eligible for an installment agreement if the following conditions apply:

- The tax liability owed does not exceed $25,000
- The installment period for payment does not exceed 60 months.
- All required valid personal income tax returns have been filed
- The taxpayer is not in an existing installment agreement

The taxpayer will apply for an installment agreement by filing FTB Form 3567 and mailing it to the Franchise Tax Board. Only newly assessed liabilities may qualify for an online installment agreement.

Mandatory Electronic Payments E-Pay

California law requires a taxpayer to submit all estimated payments or amounts paid with extension, electronically if:

- The payment exceeds $20,000
- The total tax liability on an original return is more than $80,000

Once the taxpayer exceeds $20,000 for the first payment, the mandatory electronic payment requirement will be activated. All subsequent payments would then be required to be submitted electronically, without regard to:

- The amount of the payment
- The type of tax payment
- The tax year for which the payment has been made

Taxpayers who fail to comply with the electronic payment requirement are subject to a penalty of 1% for noncompliance.

A waiver of the mandatory electronic payment requirement may be requested for one of the following reasons:

- The taxpayer has not made an estimated tax or extension payment in excess of $20,000 during the current or previous taxable year
- The taxpayer's total tax liability reported for the previous taxable year did not exceed $80,000
- The amount paid is not representative of the taxpayer's total tax liability

Interest Charged on Late Filing or Late Payment Penalty

Any late filing or late payment penalty imposed on a taxpayer will be charged interest for a period to include the original due date of the return through the date paid. Interest on underpayment of estimated tax will be charged on the underpaid amount starting from the date the installment was due through the date the installment was paid or the date the return was due, whichever is earlier. Additionally, other penalties not paid within 15 days will be charged interest from the billing notice date until the payment date. The interest rate is adjusted twice a year and interest is compounded daily. The FTB publishes a chart of interest rates on its website.

Late Filing Penalty

A late filing penalty for a delinquent return plus interest figured from the original due date of the tax return will be assessed if the taxpayer does not file his return by October 15, 20XX (or another extension date, if applicable). For every month that the return is late, the penalty is 5% of the unpaid tax due up to a maximum total penalty of 25% of the tax not paid. If the return is filed more than 60 days late, the minimum penalty is the lesser of $135 or 100% of the balance due. There is also a penalty referred to as a demand penalty if an individual does not file a tax return after a formal legal demand is sent. The penalty is 25% of the total tax amount due, regardless of any payments or credits made on time.

Late Payment of Tax Penalty

A taxpayer is charged a late payment penalty plus interest if they fail to pay his total tax liability by the original due date of his return. The penalty is 5% of the unpaid tax plus ½% for each month, or part thereof, that the tax remains unpaid, not to exceed 40 months. The penalty is imposed regardless of an extension of time to file. If the taxpayer had paid at least 90% of the tax shown on the return by the original due date of the tax return or 100% of the prior year’s tax, the FTB will waive the penalty based on reasonable cause. However, interest is mandatory on any late unpaid tax. If, after the original due date of his return, the taxpayer discovers they underestimated the amount of tax due, they should pay the remainder of the tax due as soon as possible. Otherwise, penalties and interest will continue to accumulate. This should be done using another FTB Form 3519.

Tax Payments Options

California has available several options for making a payment for personal taxes that are owed.

- Web Pay from a bank account: this is set-up via the FTB website and there is no fee to use this service. The amount paid is debited directly out of a financial institution account.
- Credit Card: this service is provided by a third party (an "official payment partner") and there is a fee for using this service.
- Mailed personal check or money order: payment mailed directly to the FTB. Payment should include a statement, notice, or payment voucher and the taxpayer's social security number needs to be included on the check. This payment method, given that the taxpayer is putting their bank account information and personal data in the mail (including their social security number) is the least secure payment method and tax preparers should encourage taxpayers to make payment by other means. FTB Form 3582, Payment Voucher, can be used if no other statement, invoice, or tax return is attached to the payment.

A taxpayer can set up a payment plan with the FTB if they are unable to pay the entire amount of their tax liability. However, the FTB must be contacted to apply for an installment agreement and there is a fee for setting this up.

California Taxes

California State Disability Insurance (CASDI)

If the taxpayer had more than one employer during the tax year and the employers withheld a combined total of more than the maximum limit in State Disability Insurance (SDI) or Voluntary Plan for Disability Insurance (VPDI), the taxpayer may claim a credit on their return for the amount over he maximum.

The SDI Withholding Rate for 2020 is 1.0 percent. The SDI taxable wage limit is $122,909 per employee for the calendar year 2020. The maximum to withhold for each employee is $1,229.09

SDI provides temporary payments to workers who are unable to perform their usual work because of pregnancy, non-occupational illness, or injury. Beginning July 1, 2014, California workers may be eligible to receive Paid Family Leave benefits when taking time off of work to care for a seriously ill parent-in-law, grandparent, grandchild, or sibling. SDI benefits are taxable only if paid as a substitute for unemployment insurance (UI) benefits. This could occur if a person was receiving UI benefits and then became disabled. When SDI benefits are received as a substitute for UI benefits, the SDI is taxable by the federal government but is not taxable by the State of California.

If any single employer withheld more than 1.0% of gross wages in 2020 the taxpayer must contact the employer for a refund. They may not claim excess SDI or VPDI on their tax return.

Mental Health Services Tax

The *Mental Health* Services Tax was implemented as part of a referendum package in 2004, titled Proposition 63, which passed in California with 53.8% of the votes. The purpose of the tax is to "provide better coordinated and more comprehensive care to those with serious mental illness, particularly in underserved populations." This tax is often referred to as the "millionaire tax" and is the revenue-generating portion of Proposition 63 intended to financially support the mental health services issue in the state of California.

Only taxpayers with California taxable income (as calculated on Form 540, line 19) in excess of $1,000,000 during a given tax year are subject to the Mental Health Services Tax. The amount of the tax is 1% of the amount of the taxpayer's income that exceeds $1,000,000 beginning with taxable years 2005 and later. So if, for example, a taxpayer has $1,250,000 of California taxable income during the tax year, the taxpayer would owe $2,500 of Mental Health Services Tax. This is a simple calculation but the following worksheet can also be used for making this calculation:

1. Taxable Income From line 19 (Form 540): ________
2. Less: $1,000,000
3. Subtotal: ________
4. Tax Rate, 1.0% (multiple line 3 by line 4) x 0.01
5. Enter the amount here and on line 62 ________

Sales and Use Tax

Retailers engaged in business in California must register with the California Department of Tax and Fee Administration (CDTFA) and pay the state's sales tax, which applies to all retail sales of goods and merchandise except those sales specifically exempted by law. The use tax generally applies to the storage, use, or other consumption in California of goods purchased from retailers in transactions not subject to the sales tax. Use tax may also apply to purchases shipped to a California consumer from another state, including purchases made by mail order, telephone, or internet.

The sales and use tax rate in a specific California location has three parts: the state tax rate, the local tax rate, and any district tax rate that may be in effect.

State sales and use taxes provide revenue to the state's general fund, to cities and counties through specific state fund allocations, and to other local jurisdictions. For example, a use tax is a type of excise tax levied by numerous state governments. It is typically the equivalent of that state's sales tax. It is assessed upon tangible personal property purchased by a resident of the assessing state for use,

storage, or consumption in that state (not for resale), regardless of where the purchase took place. If a resident of a state makes a purchase within the individual's home state, full sales tax is paid at the time of the transaction. The use tax applies when a resident of the assessing state purchases an item that is not subject to the individual's home state's sales tax. Usually, this is due to out-of-state purchases, as well as ordering items through the mail, by phone, or over the Internet from other states. The use tax is typically assessed at the same rate as the sales tax that would have been owed, if any, had the same goods been purchased in the state of residence.

For example A resident of a state with a 6.25% sales and use tax on certain goods and services, purchases non-exempt goods in another state while visiting in the other state. The individual takes the goods back to their home state for use, storage, or other consumption. If the purchaser paid less than 6.25% sales tax to the state that the purchase was made in, then the difference between what was paid and the 6.25% will be owed as a use tax to the purchaser's home state. As an example, if 4.0% sales tax was collected at the time of purchase, then the use tax will total 2.25%. If no sales tax was collected at the time of purchase, then use tax will total 6.25%. Therefore, if the same goods are purchased in a US state that does collect sales tax for such goods at the time of purchase, whatever taxes were paid by the purchaser to that state can be deducted (as a tax credit) from the 6.25% owed for subsequent use, storage or consumption in the purchases home state. With few exceptions, no state's vendors will charge the native state's sales tax on goods shipped out of state, (such-as from catalog or Internet purchases) meaning all goods ordered from out-of-state are essentially free of sales tax. The purchaser is therefore required to declare and pay the use tax to their home state on these ordered goods.

The assessing jurisdiction may make the use tax payable annually, but some states require a monthly payment. Typical exemptions include purchases by charitable non-profit organizations or governmental agencies, purchases for resale in commerce, and purchases via casual sales by individuals not in the ordinary course of business. Also, note that there are thousands of tax jurisdictions in the U.S. and many have ever-changing lists of specific types of goods and services that are not taxable.

In most cases, this complexity is part of the underlying sales tax laws; but while a brick-and-mortar store has to deal with only the sales tax laws of its own location, remote sellers have to deal with the use tax laws of many jurisdictions. This leads to the question that must be addressed here – what about Internet sales?

The Internet takes tax-free shopping to a new level. In fact, no-tax shopping has become a prime lure of online retailers looking to hook consumers on Internet buying. Despite what you sometimes hear, however, some Internet sales are subject to sales tax, and even when a site does not collect sales tax, consumers are technically responsible for remitting any unpaid sales tax on online purchases directly to their state. California's specific laws will be discussed below.

Collecting Sales Tax From Online Purchases

If an online retailer has a physical presence in a particular state, such as a store, business office, or warehouse, it must collect sales tax from customers in that state. If a business does not have a physical presence in a state, it is not required to collect sales tax for sales into that state. This rule is derived from a 1992 Supreme Court decision which held that mail-order merchants did not need to collect sales taxes for sales into states where they did not have a physical presence.

Example Mary is passionate about rare rose bushes but can't find them in California, so she orders her supplies online from an orchid supplier with headquarters in Washington. The supplier has all of its facilities in Washington and collects payment in Washington. Mary does not have to pay Washington sales tax on her roses. A few months later, the supplier opens a warehouse in California to handle its online orders for the entire country. Mary continues to order her roses from the headquarters in Washington, payment is processed in Washington but the order is shipped from a California location. She must now pay California sales tax.

For a while, some big retailers with local stores sold their products tax-free over the Internet by creating separate legal subsidiaries to handle internet business. However, lawsuits by several states and pressure from the Streamlined Sales Tax Project (a group created by states supporting the Streamlined Sales & Use Tax Agreement) have ended that practice of avoiding sales taxes.

Consumers' Responsibility to Pay Sales or Use Taxes

Consumers who live in a state that collects sales tax are technically required to pay the tax to the state even when an internet retailer doesn't collect it. When consumers are required to pay the tax directly to the state, it is referred to as use tax rather than sales tax. The only difference between sales and use tax is which person -- the seller or the buyer -- pays the state. Theoretically, use taxes are just a backup plan to make sure that the state collects revenue on every taxable item that is purchased within its borders. But because collecting use tax on smaller purchases is so much trouble, states have traditionally attempted to collect a use tax only on big-ticket items that require licenses, such as cars and boats.

That, however, may be changing. Many states have reevaluated their attitude towards collecting use taxes. For example, New York has added a line to income tax returns requiring all residents to calculate how much they should pay on the internet, mail order, or out-of-state purchases. California has begun a campaign to educate taxpayers on what's owed, as well. Look for states to continue step up use tax collections.

Will Internet purchases remain free from sales-tax? We'll find out in the coming years as Congress and state legislatures wrestle with this issue. Naturally, there is a great deal of opposition to the current approach, and state governments and brick-and-mortar retailers are seeking legislation to overturn the 1992 Supreme Court ruling. A look at the numbers explains why -- sales tax revenues currently amount to about $150 billion annually and make up approximately one-third of all state revenues. These taxes pay for everything from schools and police to roads, parks, and other state services. California alone estimates losses of over a billion dollars per year in sales tax revenues.

States that don't have a personal income tax, like Texas, are even more dependent on sales tax revenue. (The five states that don't have a sales tax -- Alaska, Delaware, Montana, New Hampshire, and Oregon -- aren't hurt at all.)

Streamlined Sales & Use Tax Project

In 2002, state governments organized to fight back. Under a state-led initiative known as the Streamlined Sales & Use Tax Agreement (SSUTA), 40 states and the District of Columbia banded together to simplify their sales tax codes in order to make sales tax collection easier. Under SSUTA, the collection of sales tax still remains voluntary. However, it is considered a necessary stepping stone to federal legislation. The SSUTA has gained traction. Several national retailers have negotiated with member states for amnesty deals in return for future collection of sales tax, and more are expected to follow. In addition, several states have already amended their tax laws to conform to the SSUTA. A few years back, the world’s largest online retailer, Amazon, came to a series of agreements with the State of California and started to charge sales tax on online purchases originating from California. With all of this pressure from states, many experts believe that within the next few years consumers will be paying more sales taxes on Internet purchases.

Use Tax for Sellers to California Residents

If an individual is selling goods or products online and some of their customers are located in California, they must be aware of California’s Internet sales tax rules. Keep in mind that collection of sales tax on Internet sales has been a matter of ongoing debate both in California and nationwide.

The federal government is currently considering legislation that would affect large Internet retailers and how online sales taxes are collected in all states. The proposed federal law (called the Marketplace Fairness Act of 2017) would allow states to require sellers not physically located in their state to collect taxes on online and catalog sales made to people in their state. Sellers that make $1 million or less in

annual sales and have no physical presence in the state would be exempt from this requirement. States would have to meet certain criteria to simplify their sales tax laws and make sales tax collection easier before they could require sellers to collect the tax. As of this writing, this bill is still pending in Congress.

Sales Tax Rules from Online Transactions in California.

Physical Presence in the State The current default rule throughout the United States is that one must collect sales tax on Internet sales to customers in those states where their business has a "physical presence."

Generally speaking, a physical presence means such things as:

- Having a warehouse in the state
- Having a store in the state
- Having an office in the state
- Having a sales representative in the state

For a more specific statement of what counts as physical presence under California law, consult Section 6203 of California's Revenue and Taxation Code (not required for this course).

The corollary to the physical-presence rule is that, if one does not have a physical presence in the state, they generally are not required to collect sales tax for an internet-based sale to someone in that state.

The following examples generally would be valid in situations where special rules did not apply. However, keep in mind that California does have new, special rules, discussed below, that apply to large online retailers.

Example 1 An individual is operating solely out of a warehouse in Memphis, Tennessee and they make a sale to a customer in Santa Monica, California—a state where their business has no physical presence. They are not required to collect sales tax from the Santa Monica customer.

Example 2 An individual is operating solely out of a warehouse in San Francisco, California and they make a sale to a customer in Santa Monica, California. They are required to collect sales tax from the Santa Monica customer.

Example 3 After several years of operating solely out of a warehouse in Memphis, Tennessee, an individual opens a one-room satellite office just outside Los Angeles, California—a state where previously they had no physical presence. A day later, they make a sale to a customer in San Diego. They are required to collect sales tax from the San Diego customer.

Non-Taxable Items Certain items sold via the Internet to California customers may be exempt from sales tax under California law.

Possible non-taxable items include:

- Sales of items for resale
- Sales of cold food products
- Products electronically transmitted to customers, such as software, eBooks, mobile applications, and digital images

California's Recent Internet Sales Tax Legislation In the Quill decision the United States Supreme Court considered, but rejected, a more ambiguous sales tax rule that, instead of physical presence, would require only a so-called " nexus" between a business and a state in order for the state to require the business to collect sales tax. A nexus may include things that go beyond an obvious physical presence. California has recently attempted to use the nexus concept to impose a sales tax collection requirement on larger Internet retailers.

More specifically, during a three-month period between late June 2011 and late September 2011, California enacted two pieces of legislation, known technically as AB 28 and AB 155, that created new standards for determining a "nexus" between a business and the state for sales tax purposes. These pieces of legislation appear to be focused on large Internet-based retailers like Amazon.com.

The two bills concern Internet retailers that may not have a physical presence in California but do have so-called "click-through" arrangements with "persons" in California. Under such arrangements, the persons in California solicit California customers and direct them to the non-California business's website. This is often accomplished by the persons in California having websites with links that connect to the out-of-state retailer's website. If the non-California business is making enough money from these directed sales, as well as enough money from California sales more generally, it will be required to collect California sales tax.

More specifically, under AB 28 and AB 155, the non-California Internet retailer must meet all of the following conditions before being required to collect California sales tax:

- Have an agreement with a person or persons in California to direct potential buyers to the retailer's website or link
- Compensate the person or persons in California for directing potential buyers to the online retailer
- The retailer's "total cumulative sales price" from directed sales to California customers must exceed $10,000 within the preceding 12 months, and
- The retailer's overall total cumulative sales in California (both directed and otherwise) must exceed $1,000,000* within the preceding 12 months

In addition, AB 28 and AB 155 also state that a "retailer that is a member of a commonly controlled group" of businesses must collect California sales tax. The more complete definition, from Section 25105 of California's Revenue and Taxation Code, indicates that a "commonly controlled group" covers such situations as businesses owned by parent corporations or two corporations with substantial overlap in stock ownership.

AB 155 largely reiterates the key provisions of AB 28. However, where AB 28 required total cumulative sales in California (directed and undirected) to exceed $500,000, AB 155 revised that figure so that such sales must exceed $1,000,000. However, while this minimum dollar amount may exclude many small and micro Internet-based businesses, it is possible that it will be revised back down in the future as California seeks more tax revenue.

As a rule, the best place to turn for additional information about a state's internet sales tax laws is the state's revenue agency. In California, the Board of Equalization has an online publication that provides a very brief overview of the state's internet sales tax law.

Paying California Use Tax

An individual may owe use tax on purchases they made from out-of-state or Internet sellers. Use tax is similar to the sales tax paid on purchases made in California. A taxpayer may report use tax on their income tax return instead of filing a use tax return with the State Board of Equalization. To report use tax on an income tax return, an individual may use either the Use Tax Worksheet or the Use Tax Lookup Table. Both are included in the tax booklet instructions.

An individual must pay California use tax when they purchase out-of-state items by telephone, Internet, mail, or in-person and both of the following apply:

- The seller does not collect California sales or use tax
- They use, give away, store, or consume the item in this state

Use Tax Worksheet When an individual chooses to use the following Use Tax Worksheet method to determine the amount of use tax owed:

Step 1: Add the amount of all purchases made from out-of-state or Internet sellers made without payment of California Sales/Use tax. Include only items that would have been subject to sales tax if they had been purchased in California. See the Board of Equalization website (link below) for more information on taxable items.

Step 2: Look up the use tax rate for the location where the items were used, given away, stored, or consumed.
Step 3: Multiply the amount by the use tax rate.
Step 4: If the Use Tax Lookup Table is used to estimate individual purchases less than $1,000, add the amount from the table.
Step 5: Subtract any sales or use tax paid to another state for the items purchased.
Step 6: Enter this amount.

If one has a combination of individual items purchased for $1,000 or more and/or items purchased for use in a trade or business not registered with the Board of Equalization, and individual, non-business items purchased for less than $1,000, they may either:

- Use the Use Tax Worksheet to compute use tax due on all purchases
- Use the Use Tax Worksheet to compute use tax due on all individual items purchased for $1,000 or more plus items purchased for use in a trade or business not registered with the Board of Equalization, and use the Estimated Use Tax Lookup Table to estimate the use tax due on individual, non-business items purchased for less than $1,000, then add the amounts

Use Tax Lookup Table Instead of reporting use tax liability using the Use Tax Worksheet one can use the Use Tax Lookup Table. The table allows individuals who are not required to hold a California Seller's Permit or a Consumer Use Tax account, to report their use tax due based on their California Adjusted Gross Income (AGI). The table can only be used for individual purchases of less than $1,000. Individual purchases of $1,000 or more must be calculated separately using the use tax worksheet.
Items to Report Directly to the Board of Equalization Report use tax due on the following items directly to the Board of Equalization. Do not report them on the personal income tax return:

- Vehicles, vessels, and trailers that must be registered with the Department of Motor Vehicles
- Mobile homes or commercial coaches that must be registered annually as required by the Health and Safety Code
- Vessels documented with the U.S. Coast Guard
- Aircraft
- Leases of machinery, equipment, vehicles, and other tangible personal property

If an individual owes use tax for prior years the Board of Equalization has established a voluntary use tax liability disclosure program for in-state qualified purchasers who wish to acknowledge their liability for California use tax. By voluntarily coming forward to the Board of Equalization under this program, one may be able to limit their liability for tax, penalties, and interest due for prior periods.
If one traveled to a foreign country and brought items back to California, generally the use tax is due on the purchase price of the goods that were listed on their U.S. Customs Declaration less than the $800 per-person exemption. This $800 exemption does not apply to goods sent or shipped to California by mail or other common carriers.
If an individual's filing status is "married/RDP filing separately", they may elect to report one-half of the use tax due or the entire amount on their income tax return. If they elect to report one-half, their spouse may report the remaining half on their income tax return or on the individual use tax return available from the State Board of Equalization.
For more information (not required for the course), the California State Board of Equalization is the best source, since they are the department that is actually responsible for collecting sales and use tax (not the Franchise Tax Board). Their link is provided here: *State Board of Equalization*

California Alternative Minimum Tax (AMT)
California has an Alternative Minimum Tax that is similar to the federal AMT. Like the Federal, the purpose of the California AMT is to make sure that certain taxpayers do not use various tax incentives to pay little or no California income tax. The California alternative minimum tax rate is 7% of the taxpayer's alternative minimum tax base. Like the calculation for federal AMT, the alternative

minimum tax base is calculated by adding to and subtracting from taxable income certain adjustments and preferences, and subtracting an AMT exemption allowance.

For the 2020 tax year, a taxpayer may owe AMT if the total income is more than the following:

Filing status	**Amount**
Married/RDP filing jointly or qualifying widow(er)	$99,707
Single or head of household	$74,780
Married/RDP filing separately, estates, or trusts	$49,851

A taxpayer is required to complete the Schedule P to calculate AMT if they owe AMT or could have their credits limited or reduced by the schedule. This is an area that requires special attention and research by the taxpayer or preparer should one encounter it. If federal AMT is owed, the taxpayer should check the state AMT requirement as well.

For the 2020 tax year phase-out limits for California are below:

Married/RDP filing jointly or qualifying widow(er)	$373,899
Single or head of household	$280,424
Married/RDP filing separately, estates, or trusts	$186,946

A qualified taxpayer shall exclude income, positive and negative adjustments, and preference items attributable to any trade or business when figuring AMT.

A qualified taxpayer is an individual, estate, or trust who:

- Owns, or has an ownership interest in, a trade or business
- Has gross receipts, fewer returns, and allowances, during the taxable year of less than $1,000,000 from all trade or businesses for which the taxpayer is the owner or has an ownership interest (“aggregate gross receipts”)

Gross receipts may include but are not limited to items reported on federal Schedules C, D, E, or F and from Form 4797 (or California Schedule D-1 if one was required to complete it) figured in accordance with California law that is associated with one's trade or business. In the case of an ownership interest, the taxpayer should include only the proportional share of gross receipts of any trade or business from a partnership, S corporation, regulated investment company (RIC), a real estate investment trust (REIT), or a real estate mortgage investment conduit (REMIC).

Credit for Prior Years Alternative Minimum Tax Similar to federal AMT, California offers a credit to taxpayers who paid AMT. For individuals and fiduciaries, FTB Form 3510 should be used to see if the taxpayer qualifies. To claim the credit for prior year AMT, individuals and fiduciaries must qualify. The requirements are that the taxpayer either had an AMT credit carryover from the prior year or paid AMT for the prior year, and had prior year adjustments and tax preference items. The standard deduction, itemized deductions, and depletion do not count as tax preference items for meeting the requirement. To claim the credit, individual taxpayers must complete and file FTB Form 3510 (review not required here for the course). While there will be no further discussion here about the actual calculation of the AMT, more information can be found by reviewing Schedule P (540) Alternative Minimum Tax and Credit Limitations. (Not required for this course).

Appreciated Contributions California does not conform to the federal treatment of contributions of appreciated property for AMT. For purposes of computing AMT under federal law contributions of appreciated property are not tax preference items. Appreciated contributions are charitable donations of property being held as a capital asset which the taxpayer has held for greater than 12 months. The California contribution deduction is figured using the cost or other basis while the federal deduction is usually figured using the FMV. Under California tax law, the amount of charitable

contributions deduction taken for appreciated property which is real, personal, or intangible is generally computed using the fair market value (FMV). The taxpayer must figure the adjusted basis of the property for purposes of computing the AMT. The amount by which the FMV (deduction taken on Schedule A) exceeds the adjusted basis in the property is the amount that must be treated as a tax preference item.

If on the federal Schedule A (Form 1040), the taxpayer contributed appreciated property to a charity and deducted the FMV, their contribution deduction must be refigured using the cost or other basis of the property. This includes capital gain and IRC Section 1231 property. If the taxpayer elected under the IRC to figure the contribution deduction using the property's adjusted basis rather than the FMV, the contribution deduction does not have to be refigured for that item of property. On line 13a of Schedule P (540), the taxpayer shall enter the amount by which their regular tax charitable contribution (usually FMV) exceeds their AMT charitable contribution (cost or other adjusted basis).

Refund of Overpaid Income Taxes - Tax Refund

A California taxpayer can request that an overpayment of taxes be reimbursed to them as a tax refund payment. A tax refund can be directly deposited into a financial institution checking or savings account. The refund can also be applied to estimated taxes due for the following tax year or the taxpayer can direct some or all of the refund to be paid, as a charitable contribution, to one of a number of non-profit organizations approved by the Franchise Tax Board (details are given later in this reading assignment). A claim for a refund for reimbursement of the overpayment of taxes paid in previous years is possible. To be valid, a claim for refund must be in writing, be signed by the taxpayer or their authorized representative, including the specific reason for the claim, and be filed within the statute of limitations.

In general, a taxpayer can file a claim for a refund the later of:

- Four years after the original return due date
- Four years after the date of a timely filed return
- One year from the date of overpayment

State Income Tax Refund

If one received a California State Income Tax refund and had to include the refund as taxable income on their federal return, they will need to subtract it as an adjustment on their California Tax return. California does not tax the state income tax refund received in the prior year. On Schedule CA(540) enter in column B the amount of state tax refund entered in column A.

State Taxes Paid to Another State

If a taxpayer paid taxes to another state on or after January 1, 2009, by California tax law they may be allowed to claim a credit or refund of an overpayment of income tax attributable to taxes paid to the other state. The claim may be filed within one year from the date tax is paid to the other state or within the general statute of limitations, whichever is later. If income tax was paid to another state on income that was also taxed by California, taxpayers may qualify for a credit. As long as the taxes relate to the same transaction, other state income taxes that were paid to the other state do not necessarily have to be in the same year that the income was taxed by California.

Schedule S, Other State Tax Credit

Schedule S is used to claim a credit against California tax for net income taxes levied by and paid to another state or U.S. possession. Schedule S can be filed by an individual filing a California personal income tax return or an estate or trust filing a California fiduciary income tax return. A separate Schedule S must be completed for each state for which a taxpayer is eligible to claim the credit.

Residents of California may claim a credit only if the income taxed by the other state has a source within the other state under California law. No credit is allowed if the other state allows California residents a credit for net income taxes paid to California.
Nonresidents of California may claim a credit only for net income taxes levied by and paid to their states of residence and only if such states do not allow their residents a credit for net income taxes paid to California. Only California nonresidents who are residents of one of the following states or U.S. possession may claim this credit; Arizona, Guam, Indiana, Oregon, or Virginia.

When itemizing deductions on your California tax return, the following California taxes must be deducted from the total taxes itemized on the federal return:

- *California State Income Tax*
- *State Disability Insurance (SDI)*
- *State Motor Vehicle Tax*

Innocent or Injured Spouse

California has adopted an Innocent Joint Filer provision. Generally, when a married/RDP taxpayer files a joint tax return, their spouse/RDP is responsible equally as a whole for paying the tax and any penalties or interest due. California adopted an innocent joint filer provision to provide full or partial relief to the "innocent spouse" from paying tax on all or part of the balance related to the other spouse's culpability. If the taxpayer or the spouse/RDP meets certain requirements, they may qualify for relief of payment. Please refer to FTB Form 705 Innocent Joint Filer Relief Request for more information.
Injured spouse relief is different than innocent joint filer relief. An injured spouse is a taxpayer who files a joint return and is due for a refund that is likely to be applied to the spouse's past-due taxes, child support, student loans, hospital bills, or other separate liability. Unlike federal tax code, California does not have an injured spouse provision. California is one of nine community property states. This topic is discussed in detail in this reading assignment.

Offer in Compromise

The FTB's *Offer in Compromise (OIC)* program allows a taxpayer to offer a lesser amount for payment of a non-disputed final tax liability. The FTB approves an offer in compromise when the amount offered represents the most the board expects to collect within a reasonable amount of time. Before preparing an offer in compromise, a taxpayer should review the information provided by the FTB in Publication 4905PIT.
The taxpayer may be a candidate if they are an individual who does not have the income, assets, or means to pay their tax liability now or in the foreseeable future. The offer in compromise program allows taxpayers to offer a lesser amount for payment of a non-disputed final tax liability.

Although the board evaluates each case based on its own unique set of facts and circumstances, the FTB weighs the following factors strongly when making the evaluation:

- The taxpayer's ability to pay
- The amount of equity in the taxpayer's assets
- The taxpayer's present and future income
- The taxpayer's present and future expenses
- The potential for changed circumstances
- Whether the offer is in the best interest of the state

The application process must be completed thoroughly according to the requirements set forth by the FTB. They will only process an offer in compromise application if all of the required tax returns have been filed. If there is no filing requirement, it must be noted on the application. The offer in compromise application must be completed in full with all supporting documentation provided. There must be an agreement between the FTB and the taxpayer as to how much of the tax is still owed. The taxpayer must give permission to the FTB to access his credit report and conduct an investigation to verify the validity of the information provided by the taxpayer on his application. A collateral agreement with a term of 5 years may be required if the taxpayer has a meaningful potential for earnings growth. A collateral agreement requires a taxpayer to pay a larger amount or 100% of the original tax liability if, during the 5 year period following approval, the taxpayer earns more than was anticipated. If this is the case, an agreed-upon earnings threshold will be established and a percentage of future earnings that exceed that threshold must be paid. Collection activity is not automatically suspended upon submission of an offer to the FTB. If a delay puts the ability to collect tax in jeopardy, collection efforts may continue. However; interest, penalties, and fees will continue to accrue. Offered funds should not be submitted until the FTB requests them and they should be submitted only with a cashier's check or money order. If an offered amount is accepted, it must be paid in one lump-sum. FTB Form 4905 Offer in Compromise for Individuals has a checklist of required items of documentation that needs to be included with the application.

Family Support Payments

In California, parents have a mutual obligation to financially support and provide health insurance for their children. The Child Support Enforcement Program provides services to assist parents with this responsibility. As a component of the District Attorney's office, the county Family Support Division is the local enforcement agency for child support (Title IV-D Office). The Family Support Division is commonly referred to as, the FSD, the District Attorney's office, D.A.'s office, or local child support agency. Family support payments may include both child support and alimony. If “family support” is written into the divorce decree or separation agreement and no part of the support payments are designated as child support, then the entire payment must be included in the recipient’s taxable income and is deductible from the taxable income of the payer. In this case, family support payments may be deductible as alimony.

Filing Status

The filing status determines the rate an individual's income is taxed. The five filing statuses are:

- Single
- Married/Registered Domestic Partnership (RDP) filing jointly
- Married/RDP filing separately
- Head of household
- Qualifying widow(er) with child

Generally, a taxpayer should file a state tax return using the same status as their federal return. If the taxpayer did not file a federal return because they did not have a federal filing requirement, they may use any filing status on their California return that they were entitled to use on their federal return had they been required to file a federal return.

Single The taxpayer is single if any of the following was true on the last day of the tax year:

- They were not married or an RDP
- They were divorced under a final decree of divorce, legally separated under a final decree of legal separation, or terminated their registered domestic partnership
- They were widowed before January 1, 2020, and did not remarry or enter into another registered domestic partnership in 2020

Married/RDP Filing Jointly One may file married/RDP filing jointly if any of the following is true:

- They were married or an RDP as of December 31, 2020, even if they did not live with their spouse/RDP at the end of 2020
- Their spouse/RDP died in 2020 and they did not remarry or enter into another registered domestic partnership in 2020
- Their spouse/RDP died in the current year before they filed a prior-year tax return.

Married/RDP Filing Separately Community property rules apply to the division of income if the taxpayer uses the married/RDP filing separately status.
When separate returns are filed, each spouse shall report the following:

- One-half of the community income
- All of his or her separate income

A taxpayer may not claim a personal exemption credit for his spouse/RDP even if his spouse/RDP had no income, is not filing a return, and is not claimed as a dependent on another person's return.
A taxpayer may be able to file head of household if they had a child living with them and they lived apart from their spouse/RDP during the entire last six months of the tax year If this filing status is used, be sure to enter the taxpayer's spouse's full name and Social Security number or Individual Taxpayer Identification Number (ITIN) in the allotted space.
Head of Household Use the head of household filing status for unmarried individuals and certain married individuals or RDP's who live apart and who provide a home for qualified relatives.

The taxpayer is entitled to file using the head of household filing status only if all the following apply:

- The taxpayer was unmarried and not in a registered domestic partnership or met the requirements to be considered unmarried or met the requirements to be considered not in a registered domestic partnership at the end of the calendar year
- The taxpayer's spouse or RDP must not have live in the taxpayer's home at any time during the last 6 months of the tax year
- The taxpayer paid more than half of the cost of keeping up his home for the tax year

- For more than half the year, the taxpayer's home was the main home for the taxpayer and for at least one specified relative who by law can qualify the taxpayer for the head of household filing status
- The taxpayer was not a nonresident alien at any time during the tax year.
- For head of household purposes, for a child to qualify as the taxpayer's foster child, the child must be placed with the taxpayer by an authorized placement agency or by order of a court.
- Parents are also considered qualified dependents. If one was unmarried and not an RDP, they may be eligible for the head of household filing status even if their father or mother did not live with them. However, their parent must have been a citizen or national of the United States, or a resident of the United States, Canada, or Mexico.

Filing status can change during the year for a taxpayer when certain events occur, such as the following (not an all-inclusive list):

- Annulment or Divorce
- Birth or Death of a family member/dependent
- Change in legal custody of a dependent
- New Multiple Support Agreement (explained later)

For taxable years beginning on or after January 1, 2015, California requires taxpayers who use head of household (HOH) filing status to file Form 3532 Head of Household Filing Status Schedule, to report how the HOH filing status was determined. This form is then attached to the tax return.
Self-Test Instructions to determine if the taxpayer qualifies for the head of household filing status are located in Publication 1540, California head of household filing status. This form is only available by request.

Although there are three self-tests, only one will apply to each taxpayer. The tests that are found in the publication are as follows:

- Complete Self-Test 1 if the taxpayer was unmarried and not an RDP as of the last day of the year
- Complete Self-Test 2 if the taxpayer was married or an RDP as of the last day of the year
- Complete Self-Test 3 if by the last day of the year, the taxpayer had received a final decree of divorce, had received a final decree of legal separation, had received a final decree of dissolution of his RDP, or had filed a Notice of Termination of Domestic Partnership with the California Secretary of State and the six-month waiting period for the notice to become final had elapsed

Qualifying Widow(er) with Dependent Child Check the box on Form 540, line 5, and use the joint return tax rates for the tax year if all five of the following apply:

- The taxpayer's spouse/RDP died during the previous two years and did not remarry or enter into another registered domestic partnership in the current tax year
- The taxpayer has a child, stepchild, adopted child, or foster child whom they can claim as a dependent
- This child lived in the taxpayer's home for all of the tax year Temporary absences, such as for vacation or school, count as time lived in the home
- The taxpayer paid over half the cost of keeping up the home for this child
- The taxpayer could have filed a joint tax return with their spouse/RDP the year they died, even if they actually did not do so

Same-Sex Couples

For the tax year 2013 and going forward, same-sex spouses must file using a married filing separately or jointly filing status on the California State tax return and do not have a choice to file as single. Prior

to 2012 same-sex spouses were required to file as single. Same-sex couple marriages performed in California after 5:00 pm on June 16, 2008, and before November 5, 2008, have been recognized as valid marriages for California purposes.

Registered Domestic Partnerships (RDP)

California affords the same rights and responsibilities to Registered Domestic Partnerships (RDPs) that previously were available only to married individuals. For California tax purposes, the same longstanding rules applicable to married individuals (relating to filing status, community property income, etc.) now apply to RDPs. California law conforms to federal law when determining filing status; however, because the federal government does not recognize domestic partners as married individuals for federal tax (IRS) purposes, RDPs must continue to file as unmarried individuals on their federal tax returns. The information above regarding same-sex couples is for couples legally married. This discussion concerns RDPs, who are not actually married.

When filing a California state return, the taxpayer must use the same filing status used on their federal income tax return, unless they are an RDP.

If the taxpayer is an RDP and they used Single as their filing status for the federal return, they must use one of the following as their filing status on the California return:

- Married/RDP filing jointly
- Married/RDP filing separately

If one did not meet federal filing requirements, they will use the filing status that they would have used had they been required to file, unless the taxpayer is an RDP. If the taxpayer is a same-sex married individual or an RDP and filed head of household for federal purposes, they may use the same filing status on their California return only if they meet the requirements to be considered unmarried or considered not in a domestic partnership. If the taxpayer entered into a same-sex legal union in another state (not a legal marriage) and that union has been determined to be substantially equivalent to a California registered domestic partnership, effective for taxable years beginning on or after January 1, 2007, the taxpayer is required to file a California income tax return using either the married/RDP filing jointly or married/RDP filing separately filing status.

For purposes of California income tax, references to a spouse, a husband, or a wife also refer to a California Registered Domestic Partner (RDP), unless otherwise specified. When we use the initials (RDP), they refer to both a California Registered Domestic "Partner" and a California Registered Domestic "Partnership," as applicable. For more information on RDPs, get FTB Publication 737, Tax Information for Registered Domestic Partners.

Beginning January 1, 2012, domestic partnership eligibility requirements were significantly revised. Currently, a couple wishing to register must meet the following requirements:

1. Both persons are of the same sex. Opposite sex couples may also establish a domestic partnership, provided one or both partners is above the age of 62, and one or both partners meet specified eligibility requirements under the Social Security Act.
2. If under age 18, written consent from the underage partner's parent or legal guardian and a court order must be obtained. A certified copy of the court order must be mailed with the domestic partnership declaration form. If no parent or legal guardian exists or if no parent or legal guardian is capable of consenting, a court may provide the underage person consent to establish a domestic partnership.
3. Neither partner is married to someone else or is a member of another domestic partnership (or an out-of-state legal equivalent) with someone else that has not been terminated, dissolved, or adjudged a nullity
4. The partners are not related by blood in a way that would prevent them from being married to each other in California.
5. Both partners are capable of consenting to the domestic partnership.

If a couple wishes to establish a confidential domestic partnership, both partners are required to share a common residence. There is no longer a common residence requirement for couples wishing to establish a standard (non-confidential) domestic partnership.
Dissolution of an RDP In most cases, a domestic partnership must be dissolved through filing a court action identical to an action for dissolution of marriage. In limited circumstances, however, a filing with the Secretary of State may suffice. This procedure is available when the domestic partnership has not been in force for more than five years. The couple must also meet many other requirements that the dissolution is both simple and uncontested: no children (or current pregnancy) within the relationship, no real estate (including certain leases), and little joint property or debt. The parties must also review materials prepared by the Secretary of State, execute an agreement dividing assets and liability, and waive claims to domestic partner support. Where all the requirements are met, the partnership will terminate six months after the filing, unless either party revokes consent.

Registered domestic partners must register with the California Secretary of State's office to qualify for this filing status. The process is simpler and less costly than entering into a marriage. Both parties must sign a declaration listing their names and address. Both signatures must be notarized. The declaration must then be transmitted to the Secretary of State along with a nominal filing fee. In this regard, it is not like a marriage or civil union. Those unions require a ceremony, solemnized by either religious clergy or civil officials, to be deemed valid.

Common Law Marriages in California A formal marriage cannot be created in the State of California by a couple's consent or cohabitation, alone. The key words regarding this law against common law marriage and its invalidity are "in the State of California." Therefore, if a man and woman live in California and think they have created a common law marriage hereby consent or cohabitation here, California courts will likely reject it and the FTB will not recognize a legal marriage for purposes of using the married/RDP filing statuses.
But there is an important exception. California law also states that if a marriage is valid pursuant to the laws of the place, such as a state or foreign country, where the marriage occurred, then California will recognize the marriage absent certain limited circumstances. In other words, if another state in the union or a foreign country recognizes a common law marriage between a couple which was entered there, the couple has a proper marriage there through their "common law" status (whatever that may mean in that other jurisdiction). If the couple then moves to California, then California will recognize a legal marriage and the couple can use one of the "married/RDP" filing statuses, as long as the union does not violate California state law. If there is a dispute as to whether a common-law marriage was established outside of California, then the Courts ultimately will need to figure out and decide if there was a common-law marriage under the laws of the other jurisdiction. Does California recognize common law marriage? The correct answer is "maybe". One cannot establish a common-law union within California but can continue in California a common-law union that was established outside of the state.

Community Property and Income

California law defines community property as any asset acquired or income earned by a married person while living with a spouse. Separate property is defined as anything acquired by a spouse before the marriage, during the marriage by gift, devise, or bequest, and after the parties separate. The law requires that the community estate be divided equally if there is no written agreement requiring a particular division of property (this would usually be in the form of a pre-nuptial agreement). This means that from the total fair market value of the community assets, the joint obligations of the parties are subtracted, yielding the net community estate. Unless agreed otherwise, each spouse must receive half of the net community estate.

The state of California considers any property acquired during a valid marriage by a couple, community property. During a divorce proceeding, a judge will equitably divide community property based on possession, the wage earnings of both parties, and the length of the couple's marriage. Unless a couple signs a prenuptial agreement, California community property law only applies if the couple divorces in the state.

A California Registered Domestic Partner (RDP) will use the same community property rules that apply to married individuals.

Separate Property State law excludes from community property in California any property owned before a couple was married, any property inherited or received as a gift during the marriage by either party, proceeds from the rent or sale of separate property, items, and money earned while legally or physically separated from the spouse and any items conveyed from one spouse to the other with the intention of designating it as separate property.

Control and Management Both parties to the marriage have equal rights to the control and management of community property. It is against the law for one spouse to withhold home furnishings and fittings or clothing items of the other spouse or any minor children of the couple.

Deeds A couple who hold the title on a piece of real estate property as joint tenants can create a written agreement to designate the property as community property rather than separate property. Joint tenancy and community property often get confused in California. When couples purchase real estate using community property and take title as joint tenants, the courts seek to consider the true intention of the couple at the time of purchase to determine the community property status.

Debts The debts of either spouse can be waged against community property by debtors. In the event that the debt was incurred by one spouse prior to the couple's marriage, the portion of the community property earned or acquired by the other spouse would not be considered liable.

Conveyance A spouse cannot give or sell community property without the consent of the other spouse. The couple must jointly consent and participate in any leasing, sale, or encumbrance of community real property. Unless a will otherwise specifies, community property automatically passes o the surviving spouse when one of the spouses dies.

The community property presumption, that property acquired during the marriage and before the date of separation is community property and must be equally divided by the spouses, may be overcome by evidence that proves:

- The property acquired during marriage was a gift, bequest, or inheritance made by a third person for the exclusive benefit of the taxpayer or their spouse
- The original source of the property acquired during marriage was a separate property asset and the property was never transmuted (transformed) into community property
- The taxpayer and/or their spouse took some action that changed the character of the property

If a spouse believes an asset is their separate property, not community, then they have the burden of overcoming the presumption (proving the property is separate despite the fact that it was acquired during marriage).

Community property in the United States that does not have a community property law adopt to a common law for property acquired in marriage also referred to as marital property. Arizona, Idaho,

Louisiana, New Mexico, Nevada, Texas, and Washington also have community property laws. In Alaska, couples may choose between community or marital property arrangements.
If the taxpayer filed married/RDP filing separately, they must follow community property rules for dividing income and deductions. Generally, the taxpayer and his spouse/RDP must each report half of the community income, plus their separate income on their individual separate returns. Property, which is not specifically identified as separate property, shall be considered community property.
Community status in California ends when married or RDP partners physically separate and have no immediate intention to reconcile. Therefore, income earned after community status terminates is treated as separate income. However, when filing married/RDP filing separate, community property rules will still apply for income earned during the year if the intent for the partners to reconcile in the future exists. For example, living separately because of employment opportunity or to take care of a sick family member in a separate location with the intent of living together again once the employment or personal family situation changes does not allow either partner's income to be excluded from community property rules during the physical separation. When separate property is commingled, it could lose its separate property status and be considered community property.

No Federal Filing Requirement
If the taxpayer had no federal filing requirement, use the same filing status for California that would have been used to file a federal return, unless the taxpayer is an RDP or the exceptions below apply to the taxpayer.
Exceptions: Married taxpayers who file a joint federal income tax return may file separate California returns if either spouse was:

- An active duty member of either the United States armed forces, or any auxiliary military branch during the tax year
- A non-resident for the entire year and had no income from California sources during the tax year

If the taxpayer or his spouse meets either of the requirements above, they may file MFS on Form 540 NR, California Nonresident or Part-Year Resident Income Tax Return.
Important: In a "Community Property State," such as California, one-half of all income earned by one spouse belongs to and is taxable to the other spouse. If the taxpayer and spouse lived together, it may be in their interest to file jointly as California is only going to tax the California source income. Filing separately could require the spouse of the person with California Source income to also file and claim their "Community Property share" of said income (Two MFS California Returns vs. One MFJ California Return). This will result in both spouses having California source income, which will disqualify them from the nonresident spouse exception, described above.

Income is not considered community property when:

- Taxpayer and spouse live together in a non-community property state
- Taxpayer and spouse live separate for the entire tax year with no immediate intent of reconciliation

California is one of nine Community Property States. Others include Arizona, New Mexico, Texas, Washington, Idaho, Nevada, Louisiana, and Wisconsin.

Prenuptial Agreements
In the U.S., prenuptial agreements (also known as premarital agreements) are recognized in all 50 states and the District of Columbia.

The following five elements are required for a prenuptial agreement to be valid:

- The agreement must be in writing (oral agreements are rarely enforceable)
- It must be entered into voluntarily
- There must be full and/or fair disclosure at the time of enactment

- The agreement cannot be unconscionable or unjust
- It must be executed by both parties (not their attorneys) using a valid legal instrument, known as acknowledgment, before a notary public.

Generally, prenuptial agreements are enforceable in California. Section 1610-1617 of the California Family code adopted the Uniform Premarital Agreement Act. In California, a prenuptial agreement is very powerful. A couple can waive their rights to share community property. It can limit spousal support, although, in a court of law, the limitation can be deemed unconscionable after the fact. It can act as a contract requiring a spouse to provide for the other upon death. It can even limit probate rights at death. However, there are some exceptions. First of all, an agreement to not seek child support is invalid and will not be upheld. Also, the entire premarital agreement will be invalid if it is not executed voluntarily. California courts have not allowed penalties written in prenuptial agreements that punish or sanction people for recreational drug use or infidelity. Courts will also not enforce issues such as the assignment of one spouse to do the dishes or that children will be raised in a particular religion. In addition, the agreement will not be enforced if it is very unfair, and all of the following are true: the first party did not disclose their finances, and the second party did not sign anything saying they did not care about the first party's finances, or the second party did not already know about the first party's finances (or could easily have known).

A pre-nuptial agreement will be deemed entered into voluntarily by the party against whom enforcement is sought if the court finds in writing or on record that all of the following occurred: The party was represented by their own legal counsel, or after being advised of the right to legal counsel, waived that right; The party had at least 7 days from the time they were initially presented with the agreement and advised of their right to legal counsel and the time the agreement was signed; the party, if not represented by legal counsel, was completely informed of the terms and overall effect of the prenuptial agreement, along with an explanation of the rights and obligations given up by signing the agreement; the agreement and any related writings were not executed under a state of duress, undue influence, fraud, or lack of mental/emotional capacity; and any other factors deemed relevant by the court.

RDPs may also enter into prenuptial agreements. A prenuptial agreement is only valid if it is executed before the marriage or the RDP was entered into. After the fact, a post-nuptial agreement would have to be drawn up. When a marriage or an RDP ends, a prenuptial agreement can be amended or revoked only by a written agreement signed by both parties, which is then enforceable without consideration.

Form CA(540), California Adjustments

California has several adjustments to income. California starts with the federal AGI, then subtracts income not taxable by California, and adds income taxable by California that was not taxable by federal law, to arrive at the California adjusted gross income.
California State tax has a schedule for adjustments, Schedule CA (540), which should be used if there are differences between Federal and California income or deductions including itemized deductions.

If the taxpayer did not itemize deductions on their federal tax return but will itemize deductions on their California tax return, you will first complete federal Schedule A (Form 1040). Check the box at the top of Schedule CA (540), Part II and complete lines 1 through 30. Attach a copy of federal Schedule A (Form 1040) and Schedule CA (540) to the Form 540.

FTB Publication 1001, Supplemental Guidelines to California Adjustments is the reference document that reviews all of the possible adjustments that can be calculated on Schedule CA(540), this form is only available by request. Publication 1001 is also helpful in reviewing the differences between California and federal law.
California adjustments consist of certain incomes that are taxed on the federal return but are not taxable on the California return. The items discussed in this chapter are either not taxable or only taxable in part on California state returns. Some of the 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 the behalf of domestic partners.
Some of the more common adjustments are reviewed below for this course. A review of the *Schedule CA(540)* itself is a good "walkthrough" of the adjustments. The link to the schedule is below and should be reviewed so that you can become familiar with it. The last section of the schedule is used to determine a taxpayer's standard deduction or the California amount of their itemized deductions.

Income Adjustments
Wages are entered on line 1 of the federal return (1040). In general, there will be no adjustments entered on Schedule CA (540) on line 7 in column B or C, unless the taxpayer received the following types of income:

- Active duty military pay
- Sick pay received under the Federal Insurance Contributions Act and Railroad Retirement Act
- Ridesharing fringe benefit
- Compensation from exercising a California Qualified Stock Option (CQSO)
- Employer health savings account (HSA) contribution
- In-Home Supportive Services (IHSS) supplementary payments

Active Duty Military Pay Under the provisions of Section 514 of the Soldiers and Sailors Civil Relief Act of 1940, active duty pay or compensation received by members of the United States armed forces or an auxiliary defense unit, is subject to state income tax only by their domicile state or home of record. Service members domiciled outside of California, and their spouses, exclude the service member's military compensation from gross income when computing the tax rate on nonmilitary income. This is true regardless of where the person is stationed. Generally, the state in which the taxpayer entered the military is his domicile or home of record. This topic is discussed in detail later in this reading assignment.
Early Distributions Not Subject to Additional Tax for Reservists California conforms to the exceptions from the penalty on early withdrawals from retirement plans for qualified distributions made after September 11, 2001. This exception is eligible only to reservists who have been serving on active duty

for at least 180 days. California conforms to the federal Heroes Earned Retirement Opportunities Act. This act provides that members of the Armed Forces serving in a combat zone can make qualified contributions to their individual retirement plans, even if the compensation on which the contribution is based is excluded from gross income.

Compensation for Injury or Sickness and Amounts Received Under Accident and Health Plans This provision allows the taxpayer to exclude from their income, compensation for their physical injuries and physical sickness when received from the following sources: state disability insurance, worker's compensation, accident insurance, and health insurance.

Sick Pay While federal law includes sick pay received under the Federal Insurance Contributions Act and Railroad Retirement Act, California excludes this item from income. Therefore, the amount of sick pay included in the federal wages on line 7, column A shall be subtracted on Schedule CA (540) on line 7, column B.

Ridesharing Program 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 (R&TC), there are no monthly limits for the exclusion of these benefits, and California's definitions of these benefits cover a wider scope. For the tax year 2020 and 2021, Federal law provides an income exclusion for the value of parking provided to $270 for parking and $270 for combined commuter highway vehicle transportation and transit passes. 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 taxi-pool, and monthly transit passes provided for employees and their dependents). Enter the amount of ridesharing fringe benefits received and included in federal income on Schedule CA (540), line 7, column B.

California Qualified Stock Option (CQSO) Compensation from exercising a California Qualified Stock Option (CQSO) may be excluded from California income. Any amount qualifying for the exclusion that was included in federal income should be entered on Schedule CA (540), line 7, column B.

A taxpayer must meet the following criteria to qualify to claim this exclusion:

- Had earned income of $40,000 or less from the corporation granting the CQSO
- Had 1,000 or less total number of shares
- The market value of the shares granted must have been less than $100,000
- The stock issued must be designated as a CQSO at the time the option is granted, by the issuing corporation. The employee must have been employed by the company at the time the option was granted

Employer Health Savings Account (HSA) Contribution The amount of employer HSA contributions shall be added to the federal income amount for California income tax purposes. On line 7, column C, any employer HSA amount from federal Form W-2, Box 12, code W should be entered. This type of contribution is taxable California income.

Employer Provided Meals According to California tax law, meals provided free of charge or at a reduced rate to an employee is wages. If employees are covered under a contract of employment or union agreement, the taxable value of meals and cannot be less than the estimated value stated in the contract or agreement. If the cash value is not stated in an employment contract or union agreement, the employer will refer to a table that will list the value of the meals (will not be reviewed here).

Interest Certain types of interest are treated differently on the federal tax return than on the California tax return. U.S. obligations, including savings bonds, treasury bills, notes, and bonds, are included in federal income. California exempts the interest from these obligations from state tax. So, the interest needs to be subtracted on Schedule CA, line 8, column B. State and municipal bond interest is generally exempt from federal tax. Non-California state and municipal bond interest must be added back into California income. This interest must be reported on Schedule CA, line 8, column C.

Dividends For the most part, there is little difference between the amount of dividends reported as federal income and California state income. The main difference is that California taxes dividends derived from other states and their municipal obligations. These types of dividends must be added to California income by entering the amount on Schedule CA, line 9, column C.

Alimony Received If the taxpayer is a nonresident alien and received alimony that was not included in his federal income, enter the alimony on line 11 in column C of Schedule CA (540). Otherwise, make no entry on this line.

Business Income/Loss California law complies with federal law regarding self-employment income, and in most areas concerning expenses. The most common difference that may require an adjustment is depreciation. Depreciation methods, accelerated write-offs, and special credits differ between federal and California state tax law. Therefore, adjustments may be necessary.

Capital Gains/Losses There are not many occasions where adjustments are made on line 13 for differences between federal and California. The California basis of certain assets differs from the federal basis due to the differences between federal and state laws. When there are differences, Schedule D (540) must be used to figure the adjustments. The Instructions for California Schedule 540(D), included with Schedule 540(D), will give the student more insight into these adjustments.

IRA Distributions Usually, no adjustments are made on line 15, Schedule CA. However, depending on when contributions were made to the IRA, there could be significant differences in the taxable amount of a distribution. If the taxable amount under federal law is greater than the amount under California law, a subtraction adjustment is needed. If the taxable amount under federal law is less than the amount under California law, an additional adjustment is needed. FTB Publication 1005 contains more information and worksheets for figuring the adjustment.

Pensions Usually, no adjustments are necessary on Schedule CA, line 16. Adjustments may be required if a taxpayer received partially taxable distributions from a pension plan or Tier 2 railroad retirement benefits during the tax year. Nonresidents of California are not taxed on pension income. Therefore, an entry for the pension income must be made on Schedule CA (540NR), line 16, Columns A and D.

Rental Income/Loss Like with business income adjustments, depreciation methods, accelerated writeoffs, and special credits differ between federal and California state tax law. This is because the recovery period or basis used to figure California depreciation may be different from the recovery period or amount used for federal. Rental estate activities conducted by individuals in California are considered to be and treated as passive activities.

Unemployment / Paid Family Leave (UI/PFL) Unemployment and paid family leave payments are reported to the taxpayer on Form 1099-G. California does not tax unemployment benefits. Any unemployment compensation which was included in the federal adjusted gross income should be entered on Schedule CA (540), line 19, column A and column B. Paid Family Leave (PFL) is pay received from the California Employment Development Department. Compensation paid from the PFL program is not taxable by California. However, it is taxable for federal purposes. Any PFL received should be entered on Schedule CA (540), line 19, column B. In 2013, California expanded family leave rights up to six weeks for individuals who have a new baby, or to care for a seriously ill spouse, domestic partner, child, or parent. Beginning in 2014, California is expanding the paid family leave definition to include workers who care for siblings, grandparents, grandchildren, and parents-in-law.

Social Security Benefits Unlike the federal government, California does not include U.S. social security benefits or equivalent Tier 1 railroad retirement (R.R.) benefits in taxable income. Therefore, California taxpayers should subtract the amount of social security/Tier 1 R.R. received on Schedule CA, line 20, column B.

California Lottery Winnings California excludes California lottery winnings from taxable income, but not lottery winnings from other jurisdictions (domestic and foreign). Therefore if one purchased a lottery ticket while visiting another state and they win, the winnings will be taxed by California as ordinary income. Winning from California Lottery issued tickets will not be subject to California tax but will be subject to federal tax and winnings of over $5,000 will be subject to federal tax withholding.

Recycling Income Federal law taxes income received from recycling beverage containers. This income is not taxable on the California return. The adjustment is made by reporting the amount of beverage container recycling income reported on the federal return on Schedule CA (540), line 21f, column B.

Turf removal New Incentive for Water Saving Changes to Landscaping California excludes from gross income any rebate issued to an individual or business taxpayer for participating in a turf removal water conservation program, applicable to taxable years beginning on or after January 1, 2014, and before January 1, 2019. Turf removal entails replacing grass with drought-tolerant plants, mulch, sand, synthetic turf, etc. Various programs are offered by local water agencies or suppliers. Many programs will offer a rebate that is calculated per every square foot of grass (turf) that is removed, up to a certain dollar limit. The rebate is California tax-free. Currently, there is a bill considering to extend the Turf Removal Rebate until January 1, 2024, however, this bill has not yet been passed.

Net Operating Loss (NOL) Carryback California has suspended the net operating loss (NOL) carryover deduction for taxable years beginning on or after January 1, 2020, and before January 1, 2023. Individuals, estates, and trusts can continue to compute carryover an NOL during this period by using FTB Form 3805V, Net Operating Loss (NOL) Computation and NOL and Disaster Loss Limitations — Individuals, Estates, and Trusts. These suspension rules do not apply to taxpayers with an AGI of less than $1,000,000 or with disaster loss carryovers. For losses incurred in taxable years beginning before January 1, 2020, the carryover period has been extended for three years; for losses incurred in taxable years beginning on or after January 1, 2020, and before January 1, 2021, the carryover period has been extended for two years; and for losses incurred on or after January 1, 2021, and before January 1, 2022, the carryover period has been extended for one year.

Mortgage Forgiveness Debt Relief For federal income tax purposes, mortgage forgiveness debt relief exclusion applied to discharges of mortgage debt occurring on or after January 1, 2007, and before December 31, 2013 (it has since been extended through December 31st, 2020). However, for California purposes, the exclusion originally applied to discharges occurring on or after January 1, 2007, and before December 31, 2012, one year earlier than the federal time frame. California Assembly Bill 1393, signed into law as Chapter 152, extended California's modified federal conformity (see modified dollar limitations for California, below) to mortgage debt forgiveness for one year, through the end of 2013, to match the federal timeframe. Specifically, the California exclusion was extended to apply to discharges occurring on or after January 1, 2013, and before January 1, 2014. The exclusion applies to qualified principal residence indebtedness up to $800,000 ($400,000 for married/RDP filing separate). The federal maximum amount of qualified principal residence indebtedness is $2,000,000 ($1,000,000 in the case of a married individual filing a separate return). California taxpayers may exclude from gross income up to $500,000 ($250,000 for married/RDP filing separate) of actual mortgage debt forgiven (there is no federal limitation). The above is for informational purposes only, as the amended 540 return may be filed for up to 4 years from the initial filing date. California taxpayers must include a copy of their federal return, including IRS Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, with their original California tax return. California law does not conform to federal law regarding the discharge of indebtedness from the disposition of a principal residence occurring on or after January 1, 2014.

California still provides relief for taxpayers who sell their principal residence in a short sale. A short sale occurs when real property is sold for less than the outstanding mortgage loan. It requires an approval from the lender. Put simply, if one walks away from a mortgage on real property in California they could incur a tax liability on the amount of the forgiven debt depending on the amount of the debt and the timing. If they sell their California property via a short sale, the IRS has determined that where the lender has agreed to a short sale for less than what is owed on the home the taxpayer will not have cancellation of indebtedness income, which may have been taxable. Instead, the amount of canceled debt is included in the amount realized in determining gain on the sale of that residence. The IRS guidance on California short sales is limited to short sales only involving a principal residence for tax years 2011 and forward. The IRS guidance did not specifically address other types of real estate transactions such as non-judicial foreclosures. This topic will not be discussed further here and it is

highly recommended that a taxpayer involved with making a decision involving mortgage debt relief or short sale seek professional legal advice.

Even though a California taxpayer may not have cancellation of indebtedness income on the short sale of their residence, they may incur capital gains income on the transaction, which could be taxable.

Clergy Housing Exclusion Both California and federal law allow members of the clergy an exclusion from income for either the rental value of a home furnished as part of their compensation or for a rental allowance paid as part of their compensation to the extent it is used to provide a home. As of January 1, 2002, under federal law, the exclusion for the rental allowance is limited to the fair rental value of the home (including furnishings and a garage) and the cost of utilities. California does not limit the exclusion for the rental allowance to the fair rental value of the home.
Earnings of American Indians Federal law taxes income received by Indians from reservation sources however California does not tax income earned by Indian tribal members who live in areas designated as “Indian country” and belong to a federally recognized Indian tribe. The taxpayer must be affiliated with the tribe where they live and receive earnings from the same tribal source that they belong to. The earnings received must be earned or received reservation source income from the same Indian country where a tribal member lives. All income earned for services performed by tribal members who live on their reservation and perform the services while on their reservation is tax-exempt. For purposes of determining the tax-exempt status of income, it does not matter if the income is paid by the tribe or by a third party, as long as the requirements detailed above are met.
Taxable Interest Income Federal law taxes the interest earned on federal bonds (U.S. debt obligations). California does not tax this interest income. Federal law does not tax interest from any state or local bonds. California taxes the interest from non-California state and local bonds. California does not tax the interest earned from California issued state and local bonds (also known as municipal bonds or “munis”). Therefore an adjustment needs to be made to taxable income, deducting any interest earned from federal debt obligations or debt obligations from the state of California (federal or California Bonds) to calculate California taxable income.
Educator Expenses California does not conform to federal law regarding educator expenses. Any deductions taken for educator expenses on the federal return will need to be added back on the California return.
Health Savings Account (HSA)
Federal law allows taxpayers a deduction for contributions to an HSA account. Contributions made on behalf of an eligible individual by an employer are excluded from W-2 wages. California does not conform to this federal provision. Enter the amount of any employer HSA contribution from IRS Form W-2, box 12, code W on line 7, column C of Schedule CA (540). If the taxpayer’s federal AGI was adjusted by an HSA savings account deduction reported on Form 1040 line 25, enter this amount on Schedule CA (540), line 25, column B.
Federal income includes distributions from HSAs that are not used for qualified medical expenses. However, these distributions are not taxable on California returns. The distribution taxed by federal should be entered on Schedule CA (540), line 21f, column B.
Interest and dividends earned on HSAs are excluded from gross income on the federal return. California does not exclude these earnings. Therefore, all interest earned and any taxable dividends earned on HSAs are taxable in the year earned. The taxpayer has a California basis in the HSA account due to this tax treatment, Current year interest earned will be entered as an adjustment on Schedule CA (540), line 8, column C. Current year taxable dividends earned will be entered as an adjustment on Schedule CA (540), line 9, column C.
Archer Medical Savings Account (Archer MSA) Distribution Generally, federal law and California law are the same. However, since California does not recognize Health Savings Accounts (HSAs), a rollover from an MSA to an HSA is treated as a distribution not used for qualified medical expenses. For California, the distribution is included in California taxable income and the additional 10% tax applies

(R&TC Section 17215). A rollover from an IRA to an HSA is treated as a distribution as well. The distribution must be included in California taxable income and an additional 2.5%% tax applies, under the rules for premature distributions (R&TC Section 17085). The amount distributed, less interest, or dividend earnings previously taxed by California should be entered on line 21f, column C.

Tuition and Fees Deduction California does not conform to federal law regarding the tuition and fees deduction. For this reason, it will usually be more advantageous to use one of the two federal education credits instead. Any deductions taken tuition and fees deduction taken on the federal return will need to be added back on the California return.

Ride-sharing Fringe Benefit Differences Under federal law, qualified transportation benefits are excluded from gross income. However, in California, there are no monthly limits for the exclusion of these benefits, and California's definitions are more expansive. Therefore, some ridesharing benefits may have been taxed on the federal return. If this is the case, the amount of ridesharing benefits received and included in federal income needs to be subtracted from California income.

Casualty and Theft Losses California law no longer follows federal law regarding the treatment of losses incurred as a result of a casualty or a disaster. To qualify as a disaster loss for federal purposes, the President of the United States must declare the area in which the disaster occurred as a disaster area, eligible for federal assistance.

Calculate the disaster loss by reporting California amounts on IRS Form 4684, Casualties and Thefts, Section A - Personal Use Property, and submitting this form with the California tax return. The taxpayer will also need to attach a statement providing the date and location of the disaster (city, county, and state.)

Determine the personal loss by using the smaller of the decrease in the fair market value of the property due to the casualty or the adjusted basis of the property. Fair market value means the amount at which property would change hands between a willing buyer and seller. Adjusted basis generally means what was paid for the property plus the cost of any improvements, less deductions such as depreciation. To determine the allowable loss, deduct insurance proceeds, or other reimbursements that were received or were expected to be received. Next, subtract $100 and then 10% of the federal adjusted gross income. Claim the remaining amount as the casualty or disaster loss.

Employee Meal Expenses and Other Business Expenses California laws no longer conform entirely to federal laws concerning meals furnished to employees. The current law under the safe harbor rules, states that all meals furnished to employees at the employer's place of business meet the convenience test under IRC Section 119 if more than one-half of the employee's furnished meals are provided on the employer's premises and are furnished for the convenience of the employer. If these conditions are satisfied, the value of all such meals is excludable from the employee's income and fully deductible to the employer. Under the TCJA employer-provided meals provided on the employer's premises are only 50% deductible. In this regard, California no longer conforms to the federal law.

This program was enacted to provide tax relief to taxpayers required to eat or stay at work to fulfill their job requirements. Common examples that most individuals are familiar with include firefighters, and live-in or resident employees (housekeepers, apartment managers, etc.).

The safe harbor rules for California conform to the federal law. Federal law does not allow a deduction for dues paid or incurred for all types of club memberships, including airline and hotel clubs. California complies with federal law. Other expenses that are usually not deductible business expenses, according to both federal and California tax law, include bribes and kickbacks; charitable contributions; dues to business, social, athletic, luncheon, sporting, airline, and hotel clubs; lobbying expenses; penalties and fines paid to a governmental agency because a law was broken; political contributions. California does not allow a business expense deduction for expenses incurred at a club that discriminates. Federal law makes no distinction concerning discrimination.

Political Activity Expenses Federal law does not allow a deduction for lobbying expenses.
Lobbying expenses include any of the following:

- Influencing federal or state legislation

- Participation in or involvement in any political campaign for, or against, any candidate for public office
- Attempting to influence the general public, or segments of the population, about election, legislative, or referendum matters
- Any communication with certain covered federal executive branch officials to influence their official actions or positions
- Researching, preparing, planning, or coordinating any of the preceding activities

Contributions to political funds and the portion of dues paid to tax-exempt organizations that contribute to political activities or lobbying expenses are nondeductible.

Generally, professional lobbyists can deduct the ordinary and necessary expenses incurred out-ofpocket as an employee in the trade or business of lobbying on behalf of another person. However, three exceptions exist:

- Taxpayers can deduct certain lobbying expenses if they are: ordinary and necessary expenses of carrying on his trade or business
- Taxpayers can deduct expenses for attempting to influence the legislation of any local council or similar governing body (local legislation). Note; an Indian tribal government is considered a local council or similar governing body
- Taxpayers can deduct in-house expenses for influencing legislation or communicating directly with a covered executive branch official if the expenses for the tax year are not more than $2,000 not counting overhead expenses

If the taxpayer is a professional lobbyist, they can deduct the expenses incurred in the trade or business of lobbying on behalf of another person. Payments by the other person to the taxpayer for lobbying activities cannot be deducted. California has decided to conform to the federal provisions.

Qualifying Performing Artist Expenses Qualifying performing artists can report their income and expenses as if they were independent contractors.

Such artists will be entitled to an above-the-line deduction for business expenses (was explained further in the Standard and Itemized Deductions Reading Assignment of this course) if they meet all of the conditions below:

- They are employed as performing artists by two or more employers during the tax year
- Expenses relating to the profession of being a performing artist exceed 10% of gross income attributable to services as a performing artist
- Adjusted gross income (before expenses relating to performing) does not exceed $16,000
- The artist received at least $200 each from any two of their employers

California generally conforms unless, potentially, if any depreciation was involved. In this case, an adjustment may be necessary on Schedule CA (540), line 24, if a depreciation deduction was claimed on IRS Form 2106 Employee Business Expenses related to the profession of being a performing artist. The allowable California depreciation must be figured and compared to the federal amount. As an example, there could be differences in the depreciation deduction such as IRC Section 179 or bonus depreciation. Any difference would be reported in Column B or C. For example, if the federal amount is more than the California amount, the difference should be entered in Column B.

Student Loan Interest California conforms to federal law concerning the student loan interest deduction with the exception of non-California domiciled military taxpayers and spouses/RDPs of non-California domiciled military taxpayers who reside in a community property state. To figure the amount to enter on line 33 of Schedule 540 (CA), military taxpayers should use the Student Loan Interest Deduction Worksheet.

Work-Related Education California complies with federal law in this area, though there is one situation (discussed below) which may require an adjustment on the California return. Taxpayers may be able to deduct work-related education expenses if they itemize deductions or file a federal Schedule C for business income (loss). In either case, expenses for education must meet certain requirements to

qualify. The education must be required by the taxpayer's employer or the law to keep their present salary, status, or job; or the education must maintain or improve skills that are needed in the taxpayer's current work. Even if the above requirements are met, the taxpayer's education may not qualify for a work-related education deduction if it is necessary to meet the minimum educational requirements of the taxpayer's current trade or business; or it is part of a study program that will qualify the taxpayer to enter a new trade or business. However, even if the education could lead to a degree, the costs of qualifying work-related education are deductible as a business expense On the California return, no adjustment will be necessary for this deduction. The one possible adjustment: if itemized deductions affected by the 2% AGI limit, using California tax law, are less than the federal amount, then an overall adjustment will be needed on Schedule CA (540), line 41. If the taxpayer filed a federal Schedule C, the deduction is not subject to the 2% AGI limit and no adjustment will be needed. An adjustment to Schedule CA (540), line 12, Business income or (loss) will be needed only if the federal business income amount differs from the California amount. In other words, the work-related education deduction amount alone will not change.

The Coverdell ESA (Formerly Known as an Education IRA). For the taxpayer's Federal return Coverdell ESA contributions are not deductible, but deposited amounts grow tax-free until they are distributed. Generally, the distributions are tax-free if they are not more than the beneficiary's adjusted qualified education expenses for the year. Federal law imposes a 10% tax on the distribution of earnings not used for qualified education expenses. California conforms to the creation and tax treatment of education savings accounts and imposes a tax of 2½% for distributions that exceed the beneficiary's qualified higher education expenses.

Domestic Production Activities Deduction The domestic production activities deduction of up to 9% of domestic production activities income allowed on the federal return does not conform to California law. The amount of deduction taken on the federal return must be included in the California adjustments on Schedule CA (540), line 35, column B. This will effectively cancel out the federal deduction allowed.

Pension Annuities, SEPs, and Nonqualified Plans

After the taxpayer calculates and reports their pension, annuity, or IRA income on their federal return, they will need to independently compute and report these sources of income on their California return. There are a few common instances where differences exist between California and federal law, the more common differences apply to early distributions, part-year, and nonresident pension income, social security and railroad retirement benefits, and Health Savings Accounts (HSAs).

If the California amount differs from the federal amount, the taxpayer will need to make a California adjustment. A California adjustment is an addition to or subtraction from the federal AGI. The federal pension, annuity, or IRA income is included in the federal AGI figure that the taxpayer lists on his California return (Forms 540 or 540NR, line 13).

A tax preparer may need to refer to FTB Publication 1005, Pension and Annuity Guidelines, for more complex situations that will not be discussed in this reading assignment. However, the information necessary for the completion of the course is presented in this reading assignment and you will not need to refer to the publication.

Similarities between California and Federal law

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 for the following situations:

- Use of the "General Rule"
- Use of the "Simplified General Rule" (sometimes called the "Safe Harbor Method")
- Treatment of IRA Rollovers
- Roth IRAs
- Archer Medical Savings Accounts (MSAs)
- Coverdell Education Savings Accounts (ESAs)
- Current-year IRA deductions
- Lump-sum credit received by federal employees

Differences between California and Federal Law

There are some differences between California and federal law. Some of the more common include the following:

- Social security and railroad retirement benefits
- Some prior-year IRA deductions
- Health Savings Accounts (HSAs)

Lump-Sum Distributions

Lump-sum distributions are treated the same as federal except that California allows tax-free recovery of:

- Contributions that were not allowed as California deductions
- Interest on certain retirement bonds

If the taxpayer received a qualified lump-sum distribution from a profit-sharing or retirement plan and was born before January 2, 1936, they may use California Schedule G-1, Tax on Lump-Sum Distributions. A beneficiary who receives a qualifying distribution after a participant's death (born before January 2, 1936) may also use Schedule G-1. For those who qualify to use Schedule G-1, its purpose is to figure the tax on lump-sum distributions by special methods that may result in less tax. Taxpayers may choose the 5.5% capital gain election or the 10-year averaging method.

This schedule may only be used one time per plan participant for a lump-sum distribution received after 1986. The tax is paid only once, rather than over the next 10 years. The tax figured will be entered on line 34 of Form 540, line 41 of Form 540NR, or line 21b of Form 541, whichever form is applicable. California law regarding the 5.5% capital gain election and the 10-year averaging method on lump-

sum distributions is generally the same as federal law. Note, however, that the California basis in a pension plan may differ from the federal basis. If a lump-sum distribution is received from a Keogh plan, the California basis includes the contributions that were not deductible for California purposes because they exceeded the California deduction limit for years prior to 1987. Also, for federal purposes, any capital gain is reduced by the amount of related estate tax. However, California does not have a comparable reduction.

Early Distributions

Early distributions are amounts withdrawn before the age of 59 ½ from qualified retirement plans, annuities, or modified endowment contracts. California law conforms to federal law, except the penalty is 2.5%, rather than 10%. Early distributions from SIMPLE plans within the first 2 years of first participation are subject to a 6% penalty, rather than the 25% federal penalty. Use FTB Form 3805P, Additional Taxes On Qualified Plans (including IRAS) and Other Tax-Favored Accounts to figure the additional tax.

If required to report additional tax, it is reported on line 63 of Form 540 or line 73 of Long Form 540NR, and “FTB 3805P” must be written on the line to the left of the amount.

The 2.5% additional tax does not apply to early distributions that meet the following Internal Revenue Code exceptions:

- Qualified retirement plan distributions (does not apply to IRAs) due to separation from service in or after the year of reaching 55 (age 50 for qualified public safety employees)
- Distributions made as part of a series of substantially equal periodic payments (made at least annually) for the life (or life expectancy) or the joint lives (or joint life expectancies) of the taxpayer and their designated beneficiary (if from an employer plan, payments must begin after separation from service)
- Distributions due to total and permanent disability
- Distributions due to death (does not apply to modified endowment contracts)
- Distributions to the extent of the deductible medical expenses that can be claimed on line 4 of federal Schedule A, Itemized Deductions, (Form 1040) (does not apply to annuity or modified endowment contracts)
- Distributions made to an alternate payee under a qualified domestic relations order (does not apply to IRAs)
- Distributions made to unemployed individuals for health insurance premiums (applies only to IRAs)
- Distributions made for higher education expenses (applies only to IRAs)
- Distributions made for the purchase of a first home; up to $10,000 (applies only to IRAs)
- Distributions due to an IRS levy on the qualified retirement plan
- Qualified distributions to reservists while serving on active duty for at least 180 days
- Other exceptions (below)

Other Exceptions

The additional tax does not apply to any distributions from a plan maintained by an employer if:

- The taxpayer separated from service by March 1, 1986
- As of March 1, 1986, the entire interest was in pay status under a written election that provides a specific schedule for distribution of the entire interest
- The distribution
- is actually being made under the written election

Rollovers

California law conforms to federal law. No adjustment is required.

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 the taxpayer became a California resident is taxable in its entirety by California.

Nonresidents of California Receiving a California Pension
After 1995, California generally stopped imposing a tax on retirement income received by a nonresident.
Therefore, in this situation, retirement income includes income from any of the following:

- A qualified plan described in Internal Revenue Code (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 military pension, even if the military service was performed in California
- A private deferred compensation plan program or arrangement described in IRC Section 3121(v)(2) (C) only if the income is either:
    - Part of a series of substantially equal periodic payments (not less frequently than annually) made over the life expectancy of the participant or those of the participant and the designated beneficiary or a period of not less than 10 years
    - 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
- 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.26

If a taxpayer is a part-year resident, during the time of residency, all California-source income is taxable. Therefore, the portion of a taxpayer’s pension during the period of residency is taxable by California. However, while legally a nonresident, none of a taxpayer’s pension received during that time period is taxable by California. Only other California sourced income would be taxable to the nonresident

Military Pension
For California resident taxpayers, military pensions are taxable by California, no matter where the service was performed. For example, a service member who was stationed in different states and/or countries during his career and receives a military pension will be taxed by California on their pension income after they become a California resident.

Social Security and Railroad Retirement Benefits
Unlike the federal government, California does not tax social security benefits reported on IRS Form SSA-1099, Tier 1 railroad retirement benefits reported on IRS Form RRB-1099, Tier 2 railroad retirement benefits reported on IRS Form RRB 1099-R, or sick pay benefits under the Railroad Unemployment Insurance Act (RUIA). Sick pay benefits are paid by the Railroad Retirement Board (RRB) when an employee is unable to work because of illness, injury, or even pregnancy, miscarriage, or childbirth. Adjustments to exclude any of this income should be made on the applicable line(s) on Schedule CA (540); lines 7, 16, or line 20b, if it was included in the taxpayer’s federal AGI.
If the taxpayer received an IRS Form RRB-1099-R, Annuities or Pensions by the Railroad Retirement Board, for railroad retirement benefits and included all or part of these benefits in taxable income in

column A of line 16, they should enter the same amount in column B. If the taxpayer received federal social security benefits, or the equivalent Tier 1 railroad retirement benefit, and included all or part of these benefits in taxable income in column A, line 20, they should enter the same amount in column B.

Health Savings Accounts (HSA)

These were discussed earlier. California does not conform to federal HSA legislation therefore a contribution to an HSA is not California tax-deductible. Interest and other earnings paid into an HAS account must be included in California taxable income.

Individual Retirement Plans (IRA) Deductions

The California treatment of IRAs is generally the same as the federal treatment for many taxpayers. However, there can be differences and there are many possible situations that can create differences. Only a few will be discussed here to give you a sense of the types of situations that you need to be aware of. It is highly recommended that a tax preparer review *FTB Publication 1005* whenever dealing with the possible taxation of any type of retirement account.

First, let us look at what is the same for some of the most common retirement accounts, the Traditional IRA: 2005 through 2019 - California law is the same as federal law. For a SIMPLE IRA, an elective deferral may be made for up to the amount listed in the chart below. For a Traditional IRA, the most that can be contributed for 2020 is the smaller of the amount listed below or 100% of the taxpayer's compensation.

- $6,000 if the taxpayer is under the age of 50
- $7,000 if the taxpayer is age 50 or older by the end of the tax year

An example of a situation that could possibly lead to a difference in the tax treatment of an IRA contribution is as follows. If a taxpayer is covered by an employer's retirement plan or if they file a joint return with their spouse who is covered by such a plan, then they may only be entitled to a partial IRA deduction on their tax return or no deduction at all, depending on their income. A taxpayer (or spouse) can make additional contributions to an IRA and elect to designate otherwise deductible contributions as nondeductible. A difference between Federal and California tax treatment can occur because they do not have to elect the same deductible / nondeductible treatment for California purposes that they did for federal purposes. If they take a different election for California, FTB Schedule CA, line 19 is where IRA deduction differences are recorded.

One significant difference occurred from 1982 through 1986 when California law was different from federal law with regards to IRAs in several significant ways. During this period of time, the maximum federal deduction for an IRA 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 one was an active participant in a qualified or government retirement plan or contributed to a tax-sheltered annuity. These differences could have led to a difference in the California basis.

And as a final example, we look at nonconformity related to Canadian RRSPs. California does not conform to the U.S.–Canada treaty that allows owners to treat Canadian registered retirement savings plans (RRSPs) and Canadian registered retirement income funds (RRIFs) like an IRA — deferring income and reporting distributions as taxable when paid. Thus, California does not conform to Rev. Proc. 2014-55, which allows taxpayers to defer the income for federal purposes without filing *IRS Form 8891, U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans*. For California purposes, taxpayers who have one of these plans must include the income from the fund in taxable income on an annual basis.

Capital Gains and Losses

A gain or loss on the sale of almost any asset is considered a capital gain or loss. In fact, most property owned by a taxpayer, whether used for personal purposes or held as an investment, is a capital asset. A taxpayer's house, furnishings, automobiles, stocks, and bonds are all capital assets. Gains and losses on the sale of assets not related to the sale of business property are initially reported on *IRS Form 8949, Sales and Other Dispositions of Capital Assets* (as long-term or short-term), and the subtotals are then carried over to federal Schedule D. One key difference between California and federal tax is that while both California and federal tax short-term capital gains as ordinary income, California also taxes long-term gains at ordinary income tax rates while federal taxes on long-term gains are based on a different scale that taxes long-term gains at a lower tax rate than ordinary income.
Generally, the taxpayer will not need to make any adjustments to the actual gain or loss. However, if the California basis of his assets differs from that of the federal, adjustments would be required.

The following occurrences would cause differences in capital gain or loss amounts between the federal and California returns (the following is not an all-inclusive list):

- 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. 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
- Disposition of property inherited before 1987. 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/RDP (will not be reviewed here). For property inherited on or after January 1, 1987, the California basis and the federal basis are generally the same. The California basis of property inherited from a decedent is generally the fair market value at the time of death
- Capital loss carryback. Federal law allows a deduction for carrybacks of certain capital losses. California has no similar provision
- Basis differences of business property. 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
- Sale of a Personal Residence. A gain on the sale of a personal residence: federal law allows for an exclusion of gain on the sale. California conforms to this provision with the exception of taxpayers serving in the Peace Corps during the 5 year period before the date of sale. The mandatory 2 year period of occupancy may be reduced by the period of service, up to 18 months. This is the only difference on the capital gains exclusion allowed for the sale of a residence. The dollar exclusion amounts, up to $250,000 ($500,000 for MFJ) are the same for both federal and California. (Further discussion below)

When Differences Exist If a difference exists between the taxpayer's federal and California capital gain or loss amount, they must complete an FTB Schedule D, California Capital Gain or Loss Adjustment. Unlike Federal law, there are no special long term capital gain rates for California. The amount of capital loss limitation for California taxpayers is the same as the federal limitation, $3,000 ($1,500 if married/RDP filing separate). However, capital loss carryovers and capital loss limitations are based only on California source income and loss items when calculating the California taxable income.

Installment Sales

If property was sold at a gain (other than publicly traded stocks or securities) and payment was received in a tax year after the year of the actual sale, then the sale is reported using the installment method unless the taxpayer elects not to do so. Get FTB Form 3805E, Installment Sale Income. Also,

use this form if payment was received in the current tax year for an installment sale made in an earlier year. The installment sales method is used to recognize revenue after the sale has occurred and when sales are stipulated under very extended cash collection terms (payments will be made over time instead of all at once).
An individual may elect not to use the installment sale method for California by reporting the entire gain on Schedule D (540) (or Schedule D-1, Sales of Business Property, for business assets) in the year of the sale and filing the return on or before the due date. FTB Form 3805E also includes more detailed instructions that will not be reviewed here.

Sale or Exchange of a Personal Residence
For the sale of a personal residence after May 6, 1997, federal law allows a taxpayer to exclude the entire gain on the sale of his main home up to the amount of $250,000 ($500,000 if married filing jointly). The taxpayer must have owned (ownership test) and occupied (use test) the residence as a principal residence for at least 2 of the 5 years before the sale. For married filing jointly couples, either the taxpayer or his spouse must meet the ownership, and both the taxpayer and spouse must meet the use test (lived in the home as the main home for at least 2 years). Also, the taxpayer must not have excluded the gain from the sale of another main home during the 2 year period before the date of the sale. California conforms to this provision. However, California 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.

Withholding on California Real Estate
For taxable years beginning on or after January 1, 2009, when California real estate is sold on an installment basis the buyer is required to withhold on the principal portion of each installment payment an amount based on either 3 ⅓% of the total sales price or the optional gain on sale withholding amount (12.3% of the gain) from FTB Form 593, Real Estate Withholding Tax Statement, line 36. Form 593 must be certified by the seller. FTB Form 593-V, Payment Voucher for Real Estate Withholding is used to remit real estate withholding payments to the Franchise Tax Board. If the taxpayer is the buyer they must withhold on the principal portion of each installment payment and complete FTB Form 593 Part V, Buyer's/Transferee's Acknowledgment to Withhold. They must have his real estate escrow person send the completed and seller’s certified FTB Form 593, and a copy of the promissory note, to the Franchise Tax Board (FTB), and FTB Form 593-V along with the withholding on the principal portion of the first installment payment. Withholding payments must be submitted within 20 days following the end of the month in which the real estate transaction occurred.
Sellers may be eligible for a release from withholding on installment payments following the close of escrow. To elect out of withholding on installment payments from the sale of California real property, the seller must fulfill the following requirements: file a California income tax return and report the entire gain on Schedule D-1 in the year of the sale. Contact the FTB by phone, fax, or mail to request a release from withholding on subsequent installment payments. The FTB will respond to the request within 30 days. The buyer must continue to withhold until FTB approval is received and the buyer is notified of the release. Other situations that do not require withholding include transactions where the total sales price (regardless of the number of parcels included in the single transaction) is $100,000 or less and certain foreclosed upon property (details will not be discussed here). More information on real estate withholding guidelines can be found in Publication 1016 (review is not required for this course).

Passive Activity Losses and the Sale of Real Estate
Ordinarily, business and investment losses are deductible from other income. However, this is not always the case for losses from real estate rentals. Special passive activity loss rules prevent many landlords from deducting their rental losses from other non-rental income such as salaries or investment income. This is particularly common for higher-income property owners. The result is that

many rental property owners can only deduct their rental losses from passive income--that is, rental income or income from other businesses in which they are not actively involved. For both Federal and California tax returns, a passive activity includes any trade or business in which the taxpayer does not materially participate, and any rental activity regardless of participation. Beginning in 1994, and for federal purposes only, rental real estate activities performed by qualified real estate professionals are not automatically treated as passive activities. California does not conform to this provision. Therefore, for California purposes, all rental activities are considered passive activities.

Without passive income, the rental losses become suspended losses that cannot be deducted until one has sufficient passive income in a future year or sell the property to an unrelated party. The individual may not be able to deduct such losses for years. Suspended losses can be carried forward indefinitely and used in subsequent years against passive activity income. They are allowed in full upon a taxable disposition.

1031 Exchanges – Exchanging Property Out of California

What is a 1031 Exchange? Property owners can sell an investment property and reinvest the sales proceeds in like-kind investment property without having to pay tax on the sale. Such transactions are known as "tax-deferred exchanges" or "1031 exchanges" (1031 being the Internal Revenue Code section that authorizes the transactions). Certain requirements must be satisfied, such as in the case of a non-simultaneous exchange, identifying and acquiring the like-kind replacement property within specified time periods after the sale of the relinquished property. Generally, as long as the proceeds from the sale of the relinquished property are invested in like-kind replacement property, the tax on the sale is essentially deferred and is payable upon a subsequent taxable sale of the replacement property.

Reporting Requirements

If one sells relinquished property in California and acquire replacement property outside of California, the State of California has some added requirements to the process. Effective January 1, 2014, all taxpayers who defer gain or loss under Section 1031 by selling relinquished property in California and acquiring replacement property outside of California will have to file an information return Form FTB 3840 California Like-Kind Exchanges with the FTB for the year of the exchange and for each subsequent year in which the gain or loss from that exchange has not been recognized.

Why is the FTB now requiring this additional reporting? The annual filing will help taxpayers and the FTB keep track of California source gain deferred under 1031 exchanges. What often happens is that after exchanging relinquished property in California for replacement property outside of California, many taxpayers later sell the replacement property, and the previously deferred California source gain is not reported to the State of California (the gain previously deferred). The new annual filing requirement will help to ensure that this California tax liability will be collected. Those taxpayers who exchange relinquished property in California for replacement property outside of California and fail to file the California information return may be issued a Notice of Proposed Assessment by the FTB to adjust their income for the previously deferred California source gain, plus penalties and interest.

As discussed in the Introduction section of this reading assignment California conforms with modifications, under the TCJA for exchanges completed after January 10th, 2019.

However, for California purposes, with regard to individuals, this limitation only applies to:

- A taxpayer who is a head of household, a surviving spouse, or spouse filing joint return with adjusted gross income (AGI) of $500,000 or more for the taxable year in which the exchange begins
- Any other taxpayer filing an individual return with AGI of $250,000 or more for the taxable year in which the exchange begins

The Affordable Care Act and California

The Affordable Care Act (ACA), also referred to as “Obamacare”, is a health care reform Act with the stated goal of making health insurance accessible and affordable to all by providing Californians with better health security by setting up modifications that expand coverage and lower health care costs.
The ACA has created marketplaces, popularly known as exchanges, where consumers can compare plans in an easier format. There are two kinds of marketplaces, and the type accessed will depend on the state where one lives. There is the federal health insurance exchange (also known as Healthcare.gov), and then there are state-run marketplaces. California has its own staterun Affordable Care Act marketplace, also known as Covered California.
California residents with low-income qualify for help with their health care costs. Depending on their income and eligibility, they may qualify for lower premiums. In addition to premiums, they may also be eligible for cost-sharing reductions including coinsurance, copayments, deductibles, and out-of-pocket maximums. To get these savings, they should enroll through Covered California. Keep in mind that those who qualify for cost-sharing reductions must enroll in Enhanced Silver Plans. These plans automatically enable one to pay lower coinsurance, copayments, deductibles, and out-of-pocket costs. To qualify for financial assistance, one must:

- Be a U.S citizen or be legally present in the country
- Enroll for health coverage through Covered California
- Not be receiving Medicare, Medi-Cal or military health benefits
- Not have health coverage from one's employer
- Have a household income that ranges between 100% – 400% of the federal poverty level

Under the ACA, most people are required to have “minimum essential coverage” through an employer, a government health program, or a health plan they purchase themselves. Those who do not have health insurance in 2018 will pay a federal tax penalty. Starting in 2019, under the TCJA, the federal penalty has been eliminated. In turn, effective January 1, 2020, the Minimum Essential Coverage Individual Mandate requires Californians to obtain and maintain qualifying health insurance coverage. Those who choose to go without coverage could face a financial penalty unless they qualify for an exemption.
When consumers file their tax return, they will have to enter information about their coverage (or their exemption) on their federal tax return. If consumers do not maintain minimum essential coverage during the year and do not qualify for an exemption, they will pay a tax penalty to the Internal Revenue Service on their tax return for that year (you can find more details on this in the Federal Tax reading assignments) California does not impose any additional tax penalties. IRS Form 1095-A, Health Insurance Marketplace Statement, confirms insurance coverage. A taxpayer must have a correct 1095-A to complete their taxes. If one is a Covered California enrollee — or they buy their insurance through any state or federally run health insurance exchange — they should receive their 1095-A forms by January 31 of the year following the year of coverage.

California Achieving a Better Life Experience (ABLE) Program

As mentioned in the Introduction section of this reading assignment, for taxable years beginning on or after January 1, 2016, the California Qualified ABLE Program was established and California generally conforms to the federal income tax treatment of ABLE accounts. This program was established to help blind or disabled United States residents save money in a tax-favored ABLE account to maintain health, independence, and quality of life. Additional information can be found in the instructions of Form 3805P, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts. A review is not required for this course.

California Individual Tax Credits

Introduction
There are a variety of tax credits that are available to California taxpayers. A complete listing of the personal income tax credits available in California can be found at this link and a complete listing of the business income tax credits available in California can be found at this link. To claim one or two credits, enter the credit name, credit code, and amount of the credit directly on Form 540 where indicated. To claim more than two credits, Schedule P (540) part III, is used and attached to the tax return. Any supporting schedules or statements are also attached to FTB Form 540. FTB Form 3514 is filed for anyone claiming the California Earned Income Tax Credit discussed in the next section. For purposes of this course, only the credits discussed below will be tested in the quiz and final test.

The California Earned Income Tax Credit (EITC)
When California passed its 2016 budget, it joined a growing list of states that have recently adopted or expanded state versions of the federal Earned Income Tax Credit (EITC). First enacted at the federal level in 1975, many believe that the federal EITC has become one of the country's most effective antipoverty programs. Others have shown how the EITC creates a strong incentive to work and works as a powerful tool for reducing income inequality. The federal EITC is discussed further in the Tax Credits Reading Assignment.
Originally, in California, for taxable years beginning on or after January 1, 2015, the refundable California Earned Income Tax Credit was available to taxpayers who earned wage income within California. However starting January 1, 2017, the California Earned Income Tax Credit will conform to federal law to include in the definition of earned income, net earnings from self-employment for the California Earned Income Tax Credit. In 2020 this credit is available to taxpayers with earned income of less than $30,000. In 2019 this credit, like 2020, was available to taxpayers with earned income of less than $30,000. One does not need a child to qualify but must file a California tax return to claim the credit and attach a completed FTB Form 3514.

Note the following differences between the California and Federal EITC:
- If one was a nonresident, they must have earned income from working in California
- Both their earned income and federal adjusted gross income (AGI) must be less than $56,844 to qualify for the federal credit and less than $30,000 to qualify for the California credit
- One may elect to include all of their (and/or all of their spouse/RDP's if filing jointly) nontaxable military combat pay in earned income for California purposes, whether or not they elect to include it for federal purposes. Review FTB Publication 1032, Tax Information for Military Personnel, for special rules that apply to military personnel claiming the EITC (this will not be discussed further here)

Step by Step Guide to Qualifying for the California EITC Start with the taxpayer's federal adjusted gross income (AGI) found on their completed federal tax return. If in the taxable year 2020 the amount on federal Form 1040, line 8b; is less than $30,000, then the taxpayer will qualify for California EITC based on income. They, and their spouse/RDP if filing a joint return, must have a Social Security number (SSN) or ITIN. For eligible taxpayers using an ITIN they should provide identifying documents upon request of the FTB. The SSN does not need to be a SSN that is valid for work.

Earned Income Tax Credit qualifications for all filers:
- If the taxpayer's filing status is married filing separately they will not qualify for the California EITC
- If the taxpayer is filing federal Forms 2555, Foreign Earned Income or 2555-EZ, Foreign Earned Income Exclusion (relating to foreign earned income) then they will not qualify for the California EITC.

- If the taxpayer or their spouse/RDP was a nonresident alien for any part of 2020 and their filing status is married filing jointly, then they will qualify for the California EITC, otherwise, they cannot take the EITC
- If the taxpayer is filing Form 540NR, they and their spouse/RDP must have lived in California for at least 183 days to qualify for the California EITC

The completion of FTB Form 3514 (which is then attached to the taxpayer's tax return) will calculate the actual amount of refundable EITC that will be used to offset tax liability or returned in the form of a tax refund. Because the credit is refundable, if California tax liability is zero, the amount of EITC remaining will be refunded back to the taxpayer.

2020 California earned income tax credit eligibility chart - available to California households with federal adjusted gross income (AGI) of:

- Less than $30,000 if there are no qualifying children.
- Less than $30,000 if there is one qualifying child.
- Less than $30,000 if there are two qualifying children.
- Less than $30,000 if there are three qualifying children.

The maximum amount of investment income to remain eligible for the credit is $3,882.

If a taxpayer claims the California EITC even though they know that they are not eligible, they may not be allowed to take the credit for up to 10 years. Also, a tax preparer must exhibit the same due diligence and care in qualifying a taxpayer for the California EITC as they would for the federal EITC. The Ethics Reading Assignment of this course addresses this further.

Young Child Tax Credit

For taxable years beginning on or after January 1st, 2020, the refundable Young Child Tax Credit (YCTC) is available to taxpayers who also qualify for the California Earned Income Tax Credit and who have at least one qualifying child who is younger than six years old as of the last day of the taxable year. The maximum amount of the credit allowable for a qualified taxpayer is $1,000. The credit amount phases out as earned income exceeds the "threshold amount" of $25,000, and completely phases out at $30,000.

Child and Dependent Care Expenses Credit

There are differences between California and federal law regarding the Child and Dependent Care Expenses Credit. The California credit is a percentage of the federal credit as modified by California law.

While a taxpayer may be eligible to claim the federal credit, they may or may not be eligible to claim the California credit due to the following differences:

- California does not allow this credit for care that is provided outside the state of California.
- Nonresident taxpayers may not claim the credit unless earned wages are from working in California or earned self-employment income is derived from California business activities.
- To qualify for the California credit, federal adjusted gross income must be $100,000 or less.
- Same-sex married couples and RDPs must file a joint California return to claim this credit. There is an exception to having to file jointly to claim the credit if the couple meets the tests to be considered unmarried or not an RDP. To be considered unmarried or not an RDP, the taxpayer and spouse/RDP must have lived apart for the entire last six months of the tax year. The taxpayer's qualifying person(s) must have lived in the taxpayer's home for greater than half the tax year, and the taxpayer must have paid for more than half the cost of keeping up the home. In addition, all other requirements for claiming the credit must be met.

Taxpayers whose federal AGI is $100,000 or less and qualify for the federal credit for Child and Dependent Care Credit on IRS Form 2441 may also qualify for the California Child and Dependent Care Expenses Credit. This is a nonrefundable credit.
Because the California credit is a percentage of the federal credit, the federal amounts must be determined before the taxpayer can figure the California credit on FTB Form 3506 therefore the federal tax return must be completed first. The FTB Form 3506 can also be reviewed which should help answer most questions that may arise from the use of this credit. The amount of California credit varies with the federal AGI and is determined by multiplying the federal credit amount by the applicable percentage as per the chart below.

Federal AGI / California Percentage of Federal Credit
$40,000 or less / 50% or .50 of federal credit
Over $40,000 but not over $70,000 / 43% or .43 of federal credit
Over $70,000 but not over $100,000 / 34% or .34 of federal credit
Over $100,000 the taxpayer will not qualify for the California credit

The taxpayer must complete and attach FTB Form 3506, Child and Dependent Care Expenses Credit, if they want to claim the credit.
Military Personnel For purposes of claiming this credit, even if the service member is domiciled outside of California, active duty pay is considered earned income from California sources. However, Military personnel who are domiciled outside of California should use their federal AGI less their military pay to determine the percentage of federal credit on the above chart. FTB Publication 1032, Tax Information for Military Personnel, has more information on this situation (this will not be reviewed further here).

A qualifying person for the Child and Dependent Care Expenses Credit:

- A child under age 13 who meets the requirements to be a dependent as a Qualifying Child. A child who turned 13 during the tax year qualifies only for the part of the year when they were 12 years old
- A spouse/RDP who was physically or mentally incapable of self-care
- Any person who was physically or mentally incapable of self-care and either:
    - Was a dependent
    - Would have been a dependent except that: they received gross income of $4,200 (2020) or more, filed a joint return, and the taxpayer, or his spouse/RDP if filing a joint return, could be claimed as a dependent on someone else's tax year return.

A Qualifying Child for the Child and Dependent Care Expenses Credit is a child who meets all of the following tests:

- Relationship Test The child must be a son, daughter, stepchild, adopted child, eligible foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of one of these. An adopted child includes a child who has been lawfully placed with the taxpayer for legal adoption even if the adoption is not yet final. An eligible foster child must be placed with the taxpayer by an authorized placement agency or by a court.
- Age Test For the purposes of qualifying for the Child and Dependent Care Expenses Credit, the child must be under 13.
- Residency Test The child must live with the taxpayer for more than half the year.
- Support Test The child must not have provided more than half of their own support.
- Joint Return Test The child must not have filed a joint federal or state income tax return with their spouse/RDP.
- Citizenship Test The child must be a citizen or national of the U.S. or a resident of the U.S., Canada, or Mexico.

Divorced, RDP Terminated, Separated, or Never-Married Parents Special rules apply in determining if the taxpayer's child meets the requirements to be his qualifying person, for divorced, RDP terminated, separated, or never-married parents, for the Child and Dependent Care Expenses Credit. Only one parent qualifies to claim a child as a qualifying person when separate returns are filed by the parents. In cases where both parents pay for child care for the same child, only one parent can qualify for the credit. Some custody agreements include a provision detailing which parent is entitled to the credit.

However, that parent must meet all eight of the following qualifications to claim the credit:

1. If one is married or an RDP, they must file a joint tax return. For an exception, see Section E, Married Persons, or RDPs Filing Separate Returns.
2. Care must be provided in California for one or more qualifying persons. See Section D, Qualifying Person Defined.
3. The taxpayer paid for care so they (and their spouse/RDP) could work or look for work. However, if the taxpayer did not find a job and does not have earned income, they do not qualify for the credit. If their spouse/RDP was a student or disabled, see the instructions for Part III, line 5.
4. The taxpayer (and their spouse/RDP) must have earned income (wages or self-employment income) during the year. See the instructions for Part III, line 4, for more information on earned income.
5. The taxpayer and the qualifying person(s) live in the same home for more than half the year.
6. The person who provided care was not their spouse/RDP, the parent of their qualifying child, or a person for whom the taxpayer can claim a dependent exemption. If their child provided the care, the child must have been age 19 or older by the end of 2020.
7. The taxpayer reports the required information about the care provider(s) in Part II, line 1, and the information about the qualifying person(s) in Part III, line 2
8. The taxpayer's federal adjusted gross income is $100,000 or less.

Credit for Senior Head of Household

An individual may claim the non-refundable senior head of household credit if they were over a certain age and had an adjusted gross income (AGI) under certain limits. The purpose of this credit is to make it easier for a senior to take advantage of the lower tax liability afforded to the head of household filing status, without having to meet all of the head of household qualifications, therefore providing additional financial relief for certain seniors that still maintain a status as head of a household. If the head of household meets all of the below-listed conditions then there is no need to qualify to use the head of household filing status order to claim the credit.

For 2020 the requirements for this credit are as follows:

- Head of Household was 65 years of age or older on December 31, 2020. If the head of household's 65th birthday is on January 1, 2021, they are considered to be age 65 on December 31, 2020.
- Qualified as a head of household in 2018 or 2019 by providing a household for a qualifying individual who died during 2018 or 2019.
- Did not have AGI over $79,539 for 2020.

Credit for Child Adoption Expenses

For the year in which an order of adoption is final, the taxpayer may claim a credit for 50% of the cost of adopting a child who is either a citizen or legal resident of the United States and who was in the custody of a California public agency or a California political subdivision. The taxpayer may include only costs directly related to the adoption process. Examples of costs include fees paid to a licensed adoption agency or the Department of Social Services and travel expenses incurred by the adoptive family related to the adoption.

If the taxpayer unsuccessfully attempted to adopt a child, even when the costs were incurred in an earlier year, they may include those costs with the costs of a later successful adoption (include the previous costs with the current costs when calculating the actual credit).

The *California Adoption Credit* is very limited. One does not qualify to claim this credit if the child was adopted from another country or even another U.S. state, or if the child was not in the custody of a California public agency or a California political subdivision. In addition, if the credit for adoption costs is claimed, then any other deduction for the expenses used to claim this credit must be reduced by the amount of the credit claimed on the tax return.

Each adoption is calculated separately if the taxpayer has more than one adoption that qualifies for the credit. The maximum credit allowed for 2020 is $2,500 per qualifying child. The credit is nonrefundable however the taxpayer may carry over the excess credit to future years until the credit is exhausted.

Credit for Dependent Parent

This nonrefundable credit is for taxpayers using the married/RDP filing separate status and who support their mother and/or father. One cannot qualify for this credit if they use any other filing status for California.

In addition to the filing status requirement, an individual may claim this credit if all of the following apply:

- The taxpayer's spouse/RDP was not a member of their household during the last six months of the year.
- The taxpayer furnished over one-half the household expenses for their dependent mother's or father's home, whether or not they lived in the taxpayer's home.
- The credit uses the same worksheet that is used to figure the Credit for Joint Custody Head of Household. If a taxpayer qualifies for the Credit for Joint Custody Head of Household and the Credit for Dependent Parent, they can only claim one of the credits. They should claim the credit that will allow the maximum benefit.

Credit for Joint Custody Head of Household

If the taxpayer child did not live in their home for more than half of the taxable year, they may qualify for the non-refundable Credit for Joint Custody Head of Household. To qualify for the credit the taxpayer may not have used the married/RDP filing jointly, head of household, or qualifying widow(er) filing status.

Some of the other qualifications include:

- The taxpayer must be unmarried at the end of 2020
- The taxpayer was married/RDP but lived apart from their spouse for the whole tax year and used the married filing separate/RDP filing status.
- The taxpayer must have furnished more than one-half of the household expenses for their home that also served as the main home of their child, step-child, or grandchild for at least 146 days but not more than 219 days of the taxable year.
- The custody arrangement for the child must be part of a decree of dissolution or legal separation or part of a written agreement between the parents where the proceedings have been initiated, but a decree of dissolution or legal separation has not yet been issued.
- If the child is married/or an RDP, the taxpayer must be entitled to claim a dependent exemption credit for the child.

Nonrefundable Renter's Credit

A taxpayer, who is a resident of California, and paid rent on a property in California that served as their primary residence for at least six months of the tax year, may qualify for the nonrefundable Renter's

Credit. In addition, to qualify for the credit the property that was rented must not be exempt from California property tax and the taxpayer must not have lived with another person for more than half the year (such as a parent) who claimed them as a dependent. A nonrefundable credit will reduce tax liability down to zero. Any unused credit is lost, it cannot be carried forward and the taxpayer will not receive the excess as a tax refund. To qualify for the credit in 2020 the taxpayer's California AGI must be $43,533 or less if single or married/RDP filing separate. The California AGI must be less than $87,066 if married/RDP filing joint, head of household, or a qualifying widow(er). The amount of the credit is limited to either $60 for a single person or $120 for a married/RDP filing joint, head of household, or qualifying widow(er). If married/RDP filing separately taxpayers lived in the same rental property and both qualify for the credit, then each spouse/RDP may take up to $60 or one spouse/RDP may take up to $120. If married/RDP filing separately taxpayers lived apart for the entire year, each spouse may claim up to $60 on their respective return if they qualify.

The Nonrefundable Renter's Credit has its own line on Form 540 and the qualification record used to determine if a taxpayer qualifies for this credit is not submitted with the taxpayer's return.

The California Competes Tax Credit

The California Competes Tax Credit is an income tax credit available to businesses that want to move their business to California or keep and grow their business in California. Tax credit agreements will be negotiated by GO-Biz (The Governor's Office of Business and Economic Development) and approved by a statutorily created "California Competes Tax Credit Committee," consisting of the State Treasurer, the Director of the Department of Finance, the Director of GO-Biz, one appointee each by the Speaker of the Assembly and Senate Committee on Rules.

The credit is not a refundable credit, but the credit can be carried forward for six years. Businesses will commit to certain employment or project investment requirements; referred to as "milestones, " as part of the credit agreement. The legislation that enacted this credit requires that Go-Biz reviews certain business books and records to ensure that businesses are in compliance with the agreed-upon milestones set in the credit agreement. In general, if the business meets the milestones for a taxable year as specified in the credit agreement, then the credit for that year is earned and may be claimed on the business tax return. If the milestones for a taxable year are not met, the credit is not earned for that taxable year.

For the fiscal year 2020-21, GO-Biz will accept applications for the California Competes Tax Credit during the following periods:

- July 27th, 2020, through August 17th, 2020
- January 4th, 2021, through January 25th, 2021
- March 8th, 2021, through March 29th, 2021.

More information can be obtained at the Go-Biz web site: Business.CA.gov (review not required for this course). This credit has been extended until January 1st, 2030.

The New Employment Credit

For taxable years beginning on or after January 1, 2014, and before January 1, 2026, the New Employment Credit (NEC) is available to a qualified taxpayer that hires a qualified full-time employee on or after January 1, 2014, and pays or incurs qualified wages attributable to work performed by the qualified full-time employee in a designated census tract or economic development area, and receives a tentative credit reservation for that qualified full-time employee. FTB Form 3554, New Employment Credit is filed to take advantage of this credit.

In order to be allowed a credit, the qualified taxpayer must also meet the following requirements:

- Have a net increase in the total number of full-time employees in California.

- If a qualified employee is terminated within the first 36 months after beginning employment, the employer may be required to recapture previously taken credits.
- An annual certification of employment is required to be filed with respect to each qualified full-time employee hired in a previous taxable year.

Cares Act HR 748

Introduction

These sections are for informational purposes only and not required for the completion of the course.

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), enacted on March 27, 2020, provides economic assistance for American workers, families, and small businesses, and preserve jobs for our American industries. It is also designed to encourage eligible employers to keep employees on their payroll, despite experiencing economic hardship related to COVID-19, with an Employee Retention Tax Credit. The following sections are taken from the CARE Act HR 748.

Individual Rebates

For the 2020 year, Section 2201 allows individual taxpayers a refundable income tax credit of $1,200 ($2,400 for married couples fi ling a joint return). A $500 credit is allowed for each qualifying child of the taxpayer. The credit is eliminated for taxpayers with adjusted gross incomes exceeding $75,000for all filers except head of household, 112,500 for head of household and $150,000 for joint returns. To be eligible for the credit, taxpayers must include valid identification numbers (e.g., Social Security numbers) on their tax returns. To check on the status of a payment go to Get My Payment. These payments are not taxable income at the federal level.

Payroll Protection Plans (PPP)

Section 1102 authorizes the Small Business Administration (SBA) to guarantee paycheck protection loans during the period beginning on February 15, 2020, and ending on June 30, 2020. During this period, in addition to a small business, any business, nonprofit organization, veterans organization, or tribal business is eligible to receive a paycheck protection loan if it employs fewer than 500 employees or the applicable SBA size standard for the relevant industry. In addition, individuals who operate as sole proprietors or as independent contractors, as well as certain self-employed individuals, are eligible to receive a paycheck protection loan. Allowable uses for such loans include (1) payroll costs, (2) continuation of group health care benefits, (3) employee salaries, and (4) rent payments. An employer can go to SBA's Lender Match Tool to find an eligible SBA lender.

Section 1106 makes recipients of paycheck protection loans eligible for forgiveness of amounts expended for payroll costs and payments of interest on mortgage obligations, rent, or utilities during the eight-week period such loans are provided. The Small Business Administration (SBA) does not lend the money, they "back" the loan that the lender provides. The CARES Act provides that forgiveness of a PPP loan is not considered taxable income at the federal level.

Pandemic Unemployment Insurance

Section 2102 requires the Department of Labor to provide pandemic unemployment assistance for up to 39 weeks to workers who (1) are not eligible for other federal or state unemployment insurance or pandemic emergency unemployment compensation; (2) meet certain conditions related to being unemployed, partially unemployed, or unable to work due to COVID-19; (3) are not able to telework; and (4) are not receiving other paid leave. The provision of such assistance may be extended beyond 39weeks under specified circumstances. Pandemic unemployment assistance payments are available retroactively for the period beginning January 27, 2020, and ending on or before December 31, 2020.

Section 2104 provides appropriations to fund federal-state agreements under which the amount of an individual's weekly unemployment compensation includes an additional $600 in federal pandemic unemployment compensation. Such payments shall apply to weeks of unemployment beginning after the date of the agreement and ending on or before July 31, 2020. Such an agreement shall not apply with respect to a state that reduces the maximum duration or average weekly benefit amount of its regular unemployment compensation as in effect on January 1, 2020.

Section 2107 provides funding for 13 additional weeks of pandemic emergency unemployment compensation through December 31, 2020, for individuals who have exhausted their rights to regular unemployment compensation and meet other specified requirements.

Platinum Professional Services want you to know although unemployment insurance benefits are taxed federally, California does not tax unemployment insurance benefits.

Charitable Contributions

For the 2020 tax year, Section 2204 allows a tax deduction for charitable cash contributions of up to $300 for taxpayers who do not itemize their tax deductions (above the line for non-itemizers).

For the 2020 tax year, Section 2205 suspends the Adjusted Gross Income (AGI) limitation (currently60% AGI) on cash contributions for purposes of the qualified charitable contribution tax deduction (Section 170 (c) organizations).

Retirement Plan Distributions & Loans

For the 2020 year, Section 2202 permits penalty-free coronavirus-related distributions from tax-exempt retirement plans up to $100,000 in a taxable year and allows the distribution to be included in income ratably over 3 years, and provides that the distribution will be treated as though it were paid in a direct rollover to an eligible retirement plan if the distribution is eligible for tax-free rollover treatment and is recontributed to an eligible retirement plan within the 3-year period beginning on the day after the date on which the distribution was received. A coronavirus-related distribution is defined as any distributions from an eligible retirement plan made on or after January 1, 2020, and before December 31, 2020, to an individual who is (1) diagnosed with the virus SARS-CoV-2, (2) whose spouse or dependent is diagnosed with such virus or disease, or (3) who experienced adverse financial consequences from being quarantined, furloughed, or laid off from work due to such virus or disease.

For the 2020 year, Section 2203 allows a temporary waiver of required minimum distributions from retirement plans and accounts in 2020. For a participant whose required beginning date occurs in2020 for example, someone who reached age 70½ in 2019 but with respect to whom no RMD was made prior to December 31, 2019, both the initial RMD due April 1, 2020, as well as the RMD for the calendar year 2020 due Dec. 31, 2020, are waived. The CARES Act does not impact the provision under the recently enacted SECURE Act that increased the age at which RMDs must begin to 72 for individuals who had not attained age 70½ by the end of 2019. Taxpayers who receive certain distributions may now roll them into an eligible retirement plan. Generally, the following distributions (from a retirement plan other than a defined benefit plan) may be rolled over: Distributions paid in 2020(or paid in 2021 for the 2020 calendar year in the case of an employee who has a required beginning date of April 1, 2021), which would have been RMDs but for the CARES Act (including substantially equal periodic payments that include payments that would have been 2020 RMDs) Distributions paid in 2021 for plan participants with a required beginning date of April 1, 2020, which would have been RMDs but for the CARES Act Further, the IRS has extended the 60-day period during which plan participants may roll over the distributions described above. Now, the rollover deadline is Aug. 31,2020, at the earliest.

Employee Retention Credit

Section 2301 allows employers a payroll tax credit for 50% of the wages paid to employees, up to$10,000 per employee, during any period in which such employers were required to close due toCOVID-19. Since this is a considered a credit it is not taxable.

Net Operating Loss (NOL)

Section 2303 modifies rules relating to net operating losses to allow taxpayers to carry back net operating losses in 2018, 2019, and 2020 for up to five years, and to offset 100% of their income with losses in taxable years beginning before 2021. IRS Notice 2020-26 states that The CARES Act did not provide additional time to fi le tentative carryback adjustment applications with respect to NOLs

arising in a taxable year beginning on or after January 1, 2018, and ending before March 27, 2019, even though the time to fi le those applications had expired as of the date of enactment. Taxpayers whose losses in these taxable years may now be carried back to an earlier taxable year due to application of Section 2303 of the CARES Act will generally be able to file amended returns to claim refunds or credits resulting from the change in the law. These taxpayers, however, would not be able to take advantage of the expedited § 6411 tentative carryback adjustment procedure without an extension of time to file IRS Form 1139 Corporation Application for Tentative Refund or IRS Form 1045 Application for Tentative Refund. The Department of the Treasury and the IRS grant a six-month extension of time to file IRS Form 1045 or IRS Form 1139, as applicable, to taxpayers that have an NOL that arose in a taxable year that began during calendar year 2018 and that ended on or before June 30, 2019. This extension of time is limited to requesting a tentative refund to carry back an NOL and does not extend the time to carry back any other item.

California does not conform to federal NOL changes

Other Miscellaneous Provisions

Section 2206 allows an exclusion from employee income, for income tax purposes, of employer payments of student loans whether to the employee or to the lender, of principal or interest on any qualified loan made before January 1, 2021.

Section 2304 repeals in 2018 and 2019 the $250,000 limitation on the net business losses of individuals other than corporations.

Section 2306 increases for taxable years beginning in 2019 and 2020 the limitation on the deductibility of business interest retroactivity resided to 2018 through 2020.

Section 2307 classifies qualified improvement property (certain improvements to the interior of nonresidential real property) as 15-year property for depreciation purposes retroactive rescinded to2018 through 2020.

Section 3701 allows individuals who have high deductible health plans (HDHPs) for purposes of health savings accounts (HSAs) to also have supplemental coverage for tele-health services. Additionally, a health plan may not fail to qualify as an HDHP solely because the plan does not have a deductible for tele-health services. The section's changes apply to plan years beginning on or before December 31,2021.

Section 3702 includes menstrual products as qualifying purchases under HSAs, Archer Medical Savings Accounts (MSAs), health flexible spending arrangements (FSAs), and health reimbursement arrangements (HRAs). The section also repeals current restrictions that require drugs to be purchased with a prescription in order to qualify under HSAs, Archer MSAs, FSAs, and HRAs. The section's changes apply to purchases made after December 31, 2019.

Families First Coronavirus Response Act HR 6201

Introduction

The Families First Coronavirus Response Act (FFCRA) which was enacted on March 18, 2020, provides small and midsize employers two refundable tax credits to reimburse employers dollar-for-dollar the costs of providing paid sick leave and paid family and medical leave to employees unable to work because of the coronavirus (COVID-19). These credits are refundable. That means if the amount of the credit exceeds the amount of tax owed, the remainder is refunded to the business or organization. The law is intended to allow employers to keep employees on their payrolls, while at the same time making sure employees aren't forced to choose between their paychecks and public health measures needed to combat COVID-19. These credits are available to eligible employers beginning April 1, 2020, for qualifying leave they provide between April 1, 2020, and December 31, 2020. The section below was taken from the Families First Coronavirus Response Act HR 6201.

Tax Credits for Paid Sick and Paid Family and Medical Leave

Section 7001 is the first credit which allows a credit against payroll taxes for 100% of the employer-paid qualified sick leave wages paid each calendar quarter, subject to specified limitation. The credit is designed to compensate employers for the cost of providing two weeks paid sick leave under the Fair Labor Standards Act (FLSA) to employees is differentiated based on the reason for the sick leave. Qualified sick leave wages are wages (as defined in section 3121(a) of the Internal Revenue Code for social security and Medicare tax purposes) that Eligible Employers must pay eligible employees for periods of leave during which they are unable to work or telework because the employee:

- Is subject to a Federal, State, or local quarantine or isolation order related to COVID-19;
- Has been advised by a health care provider to self-quarantine due to concerns related to COVID-19;
- Is experiencing symptoms of COVID-19 and seeking a medical diagnosis;
- Is caring for an individual who is subject to a Federal, State, or local quarantine or isolation order related to COVID-19, or has been advised by a health care provider to self-quarantine due to concerns related to COVID-19;
- Is caring for a child of such employee if the school or place of care of the child has been closed, or the child care provider of such child is unavailable due to COVID-19 precautions; or
- Is experiencing any other substantially similar condition specified by the Secretary of Health and Human Services in consultation with the Secretary of the Treasury and the Secretary of Labor.

The amount of sick leave wages taken into account for purposes of the credit may not exceed $200for any employee ($511 per day employees as defined under the Emergency Paid Sick Leave Act) and the aggregate number of days (up to two weeks) taken into account is limited to 10 (80 hours), over the number of days taken into account for preceding calendar quarters. The credit is claimed against the employer portion of payroll taxes. The credit can be claimed via an employer's quarterly Form 941 filing, beginning with the second quarter fi ling due in July 2020. If employers do not have enough federal employment taxes to cover the amount of the credits, after they have deferred deposits of employer Social Security taxes under the CARES Act, they may request an advance payment of the credits from the IRS by submitting IRS Form 7200, Advance Payment of Employer Credits Due toCOVID-19. They may fax their completed forms to 855-248-0552.

Section 7002 allows a refundable income tax credit for 100% of sick leave amounts of self-employed individuals under the Emergency Paid Sick Leave Act. For other employees, the credit percentage is67.

Self-employed individuals must maintain documentation prescribed by the Internal Revenue Service to establish eligibility for the credit.

Section 7003 is the second credit which allows an employer a 100% payroll tax credit for qualified family leave wages paid by such employer for each calendar quarter. The credit is designed to compensate employers for the cost of providing paid family leave to employees under the Family Medical Leave Act (FMLA) for the ten weeks following the two weeks of sick leave applies more narrowly than the credit for sick leave. It is applicable only to wages paid for family leave to employees who are caring for a child whose school or place of care has been closed. The amount of qualified family leave wages that may be taken into account for each employee is limited to $200 per day and$10,000 for all calendar quarters. As with Section 7001 credit, the credit can be claimed via an employer's quarterly Form 941 fi ling, beginning with the second quarter fi ling due in July 2020. If employers do not have enough federal employment taxes to cover the amount of the credits, after they have deferred deposits of employer Social Security taxes under the CARES Act, they may request an advance payment of the credits from the IRS by submitting IRS Form 7200, Advance Payment of Employer Credits Due to COVID-19. They may fax their completed forms to 855-248-0552.

Section 7004 allows a refundable income tax credit for 100% of the qualified family leave amounts of self-employed individuals, subject to a specified formula for determining the leave amounts. Self-employed individuals must maintain documentation prescribed by the Internal Revenue Service to establish eligibility for the credit.

Section 7007 provides that wages required to be paid to employees under the Emergency Paid Sick Leave Act and the Emergency Family and Medical Leave Expansion Act shall not be considered wages for purposes of the Federal Insurance Contributions Act (FICA).

IRS People First Initiative - IR-2020-59

Introduction

On March 25, 2020, the IRS announced The People First Initiative to provide compliance relief to taxpayers experiencing COVID-19 related hardships. This relief includes issues ranging from postponing certain payments related to Installment Agreements and Offers in Compromise to collection and limiting certain enforcement actions. This section was taken from the IRS People First Initiative - IR - 2020-59.

Existing Installment agreements

For taxpayers with an existing installment agreement, the IRS is suspending installment agreement payments during the suspension period; however, interest will continue to accrue on any unpaid balances. Furthermore, the IRS will not default any installment agreements during the suspension period. The suspension period is from April 1st to July 15th, 2020.

New Installment Agreements

Taxpayers unable to fully pay their federal taxes can resolve outstanding liabilities by entering into a monthly payment agreement with the IRS.

Offers in Compromise (OIC)

The IRS is taking several steps to assist taxpayers in various stages of the OIC process:

Pending OIC Applications The IRS will allow taxpayers until July 15 to provide additional information the IRS requested to support a pending OIC. In addition, the IRS will not close any pending OIC request before July 15, 2020 without the taxpayer's consent.

OIC Payments The IRS is giving taxpayers the option of suspending all payments on accepted OICs until July 15, 2020, although by law interest will continue to accrue on any unpaid balances

Delinquent Return Filing The IRS will not default an OIC for those taxpayers who are delinquent in filing their tax return for tax year 2018. However, taxpayers should fi le any delinquent 2018 return (and their2019 return) on or before July 15, 2020.

New OIC applications Taxpayers facing a tax liability that exceeds their net worth may be able to resolve that liability using the OIC process, which is designed to resolve outstanding tax liabilities by providing a “Fresh Start."

Field Collection Activities

Field revenue officers will not initiate liens and levies (including any seizures of a personal residence) during the suspension period. However, “fi eld revenue officers will continue to pursue high-income non-filers.”

Automated Liens and Levies

The IRS will not be issuing new automatic, systemic liens and levies during the suspension period.

Passport Certifications to the State Department

The IRS will not send new certifications to the State Department for taxpayers who are “seriously delinquent” (i.e. owe more than $52,000 in taxes) during the suspension period. These “seriously delinquent” taxpayers are encouraged to request an installment agreement or, if applicable, an OIC to resolve their outstanding tax liability.

Private Debt Collection

The IRS will not send new delinquent accounts to private collection agencies to work during the suspension period.

New Field, Office and Correspondence Audits

During the suspension period, the IRS generally will not start new fi eld, office and correspondence audits. However, the IRS may start new audits when necessary to protect the government's interest in preserving the applicable statute of limitations. Also, in instances where it's in the best interest of both the IRS and the taxpayer, the IRS may move forward with a new audit during the suspension period on the understanding that COVID-19 developments could later reduce audit activities for an agreed period. Existing fi eld, office and correspondence audits. The IRS has suspended in-person meetings for current fi eld, office and correspondence audits. However, where possible, IRS examiners will continue their audits remotely. The IRS asks taxpayers with open audits to respond to any requests for information from examiners that they have already received, and any that they may receive, if they are able to do so.

Earned Income Tax Credit and Wage Verification Reviews

Taxpayers have until July 15, 2020, to submit verification to the IRS that they qualify for the Earned Income Tax Credit or verification of their income. These taxpayers should exercise their best efforts to obtain and submit all requested information, and if unable to do so, to reach out to the IRS indicating the reason such information is not available. Until July 15, 2020, the IRS will not deny these credits fora failure to provide requested information.

Independent Office of Appeals (IOA)

Appeals employees will continue to work their cases during the suspension period. Although Appeals is not currently holding in-person conferences with taxpayers, conferences may be held over the telephone or by video conference. The IRS asks taxpayers with cases in IOA to promptly respond to any IOA requests for information.

Statute of Limitations

The IRS will continue to take steps where necessary to protect all applicable statutes of limitations. In instances where a statute might expire during the suspension period, the IRS asks taxpayers to cooperate in extending such statutes. Otherwise, the IRS will issue Notices of Deficiency and pursue other similar actions to protect the government's interests in preserving such statutes. Where a statutory period is not set to expire during 2020, the IRS is unlikely to pursue an extension or issue a deficiency notice until at least July 15, 2020.

Other SBA/Treasury & IRS Pronouncements

Small Business Administration (SBA)

In response to the Coronavirus (COVID-19) pandemic, the SBA states that small business owners in all U.S. states, Washington D.C., and territories are able to apply for an Economic Injury Disaster Loan advance of up to $10,000. This advance is designed to provide economic relief to businesses that are currently experiencing a temporary loss of revenue. This loan advance will not have to be repaid. Recipients do not have to be approved for a loan in order to receive the advance, but the amount of the loan advance will be deducted from total loan eligibility. SBA will begin accepting new Economic Injury Disaster Loan (EIDL) and EIDL Advance applications on June 15 to qualified small businesses and U.S. agricultural businesses.

IRS Notices

IR-2020-15 High-deductible health plans (HDHPs) will not lose that status because they cover the cost of testing for or treatment of COVID-19 before plan deductibles have been met. The notice applies only to HSA-eligible HDHPs.

IR-2020-23 automatically postpones due dates for "Affected Taxpayers" (as defined by this notice), with respect to an expanded list of federal tax returns, tax payments, forms, and schedules due on a date during the period beginning April 1, 2020, and ending July 15, 2020. The postponed due date is July 15, 2020. Notice 2020-23 also provides relief with respect to "Specified Time-Sensitive Actions" that are due to be performed on or after April 1, 2020, and before July 15, 2020, such as filing all petitions with the Tax Court, seeking review of a decision rendered by the Tax Court, fi ling a claim for credit or refund of any tax, and bringing suit upon a claim for credit or refund of any tax. For purposes of the IRS notice, the term Specified Time-Sensitive Action also includes an investment at the election of a taxpayer due to be made during the 180-day period described in section 1400Z-2(a)(1)(A) of the Code. Affected taxpayers have until July 15, 2020, to perform the Specified Time-Sensitive Actions. The Notice postpones for 30 days the due dates with respect to certain "Time-Sensitive Government Acts"—such as examinations, cases in Appeals, and fi ling certain amended returns or submitting payments for which the time for assessment would otherwise expire if the last day for performing such acts is on or after April 6, 2020, and before July 15, 2020. Finally, Notice 2020-23 postpones the time for tax return preparers to apply to participate in the calendar year 2020 annual filing season program until July 15, 2020.

Revenue Procedures

The Treasury Department and the Internal Revenue Service issued guidance that provides relief to individuals and businesses affected by travel disruptions arising from the COVID-19 emergency. The guidance includes the following: Revenue Procedure 2020-20, which provides that, under certain circumstances, up to 60 consecutive calendar days of U.S. presence that are presumed to arise from travel disruptions caused by the COVID-19 emergency will not be counted for purposes of determining

U.S. tax residency and for purposes of determining whether an individual qualifies for tax treaty benefits for income from personal services performed in the United States; Revenue Procedure 2020-27 (PDF), which provides that qualification for exclusions from gross income under I.R.C. section 911will not be impacted as a result of days spent away from a foreign country due to the COVID-19emergency based on certain departure dates; and which provides that certain U.S. business activities conducted by a nonresident alien or foreign corporation will not be counted for up to 60 consecutive calendar days in determining whether the individual or entity is engaged in a U.S. trade or business or has a U.S. permanent establishment, but only if those activities would not have been conducted in the United States but for travel disruptions arising from the COVID-19 emergency.

Quiz

The following quiz is provided to test your knowledge based off the information presented in this course material. This quiz will not be graded and does not provide any CE credits. To receive credit for this course, you will need to complete the Final Exam on our website.

1. **For the year in which an order of adoption is entered, you may claim a credit for ___ of the cost of adopting a child who is a citizen or legal resident of the U.S. or in the custody of a California public agency or political subdivision**
   a. 25%
   b. 100%
   c. 33%
   d. 50%

2. **The taxpayer must use the same filing status for California that was used on his/her Federal Income Tax Return except under certain circumstances where a joint return was filed for federal but a separate return is filed for California. Those circumstances include:**
   a. Either spouse was an active member of the U.S. armed forces or any auxiliary military branch during the year
   b. Either spouse was a non-resident for the entire year and had no income from California sources during the year
   c. Both A and B
   d. None of the above, there are no exceptions

3. **In California, if Registered Domestic Partnerships (RDP) used the single filing status of their federal return they must use the following filing status(es) on their California return:**
   a. Married/RDP Filing Jointly
   b. Married/RDP filing Separately
   c. Head of Household/RDP
   d. A or B

4. **Tom and Tina are married and file Married Joint on their Federal tax return. Tom was a resident of a non-community property state for the entire year and earned no income from California sources. Tina was a California resident for the entire year and worked in Los Angeles full time for a marketing firm. They would like to file a joint California return. Which form must they file to do this?**
   a. Form 540
   b. Form 3800
   c. Form 540NR
   d. You can not file a Joint California return in this situation

5. **If a taxpayer receives a lump-sum distribution from a profit sharing or retirement plan the tax on the Distribution is figured on:**
   a. Schedule G-1
   b. Form 3800
   c. The Tax Table
   d. Form 5870-A

6. **Which of the following statements regarding IRA distributions is not correct?**

a. The method of taxing IRA distributions is generally the same for California and Federal purposes
b. FTB Publication 1005 can help with any California IRA distribution questions you may have.
c. Before 1987, the maximum IRA contribution that you were allowed to deduct from California income was less than the amount allowed from Federal income
d. You may file Form 540EZ2 or 540 if you have a Roth IRA distribution.

7. Interest earned from U.S. Treasury bills, notes, and bonds is not taxed by California. If the taxpayer paid federal tax on this interest then the adjustment is taken on ______ by entering the amount of the interest on Line 8 Column B.

a. Schedule CA (540)
b. Form 540 (A)
c. Schedule A
d. Form 540CA

8. An individual may be able to file as head of household if their child lives with them and they lived apart from their spouse/RDP during __________.

a. The entire year
b. The entire last six months of the year
c. Any six month period during the year
d. Any significant period during the year

9. For the 2020 tax year, which of the following taxpayers is required to file a California State Income Tax Return?

a. A 26 year old single filer with no dependents with a California gross income of $11,065
b. A 66 year old single filer with one dependent with a California gross income of $45,500
c. A 45 year old Married Filing Joint/RDP taxpayer with two dependents, a 41 year old spouse and a California gross income of $32,036
d. A 59 year old Qualifying Widow with one dependent and a California gross income of $25,200.

10. What is the California Standard Deduction for a Married /RDP Filing Joint taxpayer for the 2020 tax year?

a. $4,537
b. $4,401
c. $9,202
d. $4,601

Quiz Answer Key

Question 1 Correct Answer: D
Question 2 Correct Answer: C
Question 3 Correct Answer: D
Question 4 Correct Answer: C
Question 5 Correct Answer: A
Question 6 Correct Answer: D
Question 7 Correct Answer: A
Question 8 Correct Answer: B
Question 9 Correct Answer: B
Question 10 Correct Answer: C

Final Exam

2021 California Personal Income Tax

The following exam is attached only for your convenience. The questions below are the actual exam questions that you will be given when taking the online exam. Please log into your account online and take the Final Exam from the course details page where you will be allowed to submit your answers. A passing score of 70 percent or better will receive course credit and a Certificate of Completion.

1. **For the year in which an order of adoption is entered, you may claim a credit for ___ of the cost of adopting a child who is a citizen or legal resident of the U.S. or in the custody of a California public agency or political subdivision**
    a. 25%
    b. 100%
    c. 33%
    d. 50%

2. **The taxpayer must use the same filing status for California that was used on his/her Federal Income Tax Return except under certain circumstances where a joint return was filed for federal but a separate return is filed for California. Those circumstances include:**
    a. Either spouse was an active member of the U.S. armed forces or any auxiliary military branch during the year.
    b. Either spouse was a non-resident for the entire year and had no income from California sources during the year.
    c. Both A and B.
    d. None of the above., there are no exceptions

3. **California Registered Domestic Partners (RDP), have the same legal benefits, protections, and responsibilities as married couples unless otherwise specified, including rules related to community property and the commingling of assets. For tax information related to RDPs a tax preparer can refer to FTB Publication _____.**
    a. 737
    b. 3885A
    c. 1040A
    d. 1032

4. **In California, Registered Domestic Partnerships (RDP) must use the following filing status(es):**
    a. Married/RDP Filing Jointly
    b. Married/RDP filing Separately
    c. Head of Household/RDP
    d. A or B

5. **Service members domiciled outside of California, and their spouses, will ______ the service member's military compensation when computing the tax rate on nonmilitary income.**
    a. Exclude
    b. Include

c. Add
d. Subtract

6. Which of the following is a requirement for filing Head of Household on a California return?
a. You paid more than one-half the costs of keeping up your home for the year.
b. You were unmarried or considered unmarried for at least the last six months of the year
c. The qualifying person is a relative or close, personal friend.
d. All of the above are requirements that must be met

7. Which of the following is not a requirement for filing Head of Household on a California return?
a. You were unmarried or considered unmarried on the last day of the year.
b. For the entire year, your home was the main home for you and your qualifying relative who lived with you.
c. You paid more than one-half the costs of keeping up your home for the year.
d. You were not a nonresident alien at any time during the year.

8. If you are unmarried you may be eligible to claim Head of Household filing status if you have supported your mother or father, even if he or she did not live with you. However:
a. Your parent must have been a citizen of the U.S.
b. Your parent must have been a resident of the U.S.
c. Your parent must have been a resident of Mexico or Canada
d. All of the above are possibilities.

9. A foster child was placed with the taxpayer by order of a court. In order to meet the Head of Household filing status, which of the following is true?
a. The child cannot be claimed as the taxpayer's dependent and will not qualify them for the Head of Household filing status
b. The child may be claimed as the taxpayer's dependent and will qualify the taxpayer for the Head of Household filing status
c. The child may be claimed as the taxpayer's dependent but will not qualify the taxpayer for the Head of Household filing status
d. The child cannot be claimed as the taxpayer's dependent but will qualify the taxpayer for the Head of Household filing status

10. In a community property state (such as California) income generated from community property is community income and community income must be equally divided between spouses when a married filing separate return is filed. When separate property is ______, it could lose its separate property status and be considered community property.
a. Commingled
b. Disenfranchised
c. Divided
d. Disjoined

11. If you receive a lump-sum distribution from a profit sharing or retirement plan the tax on the Distribution is figured on:

a. Schedule G-1
b. Form 3800
c. The Tax Table
d. Form 5870 A

12. Which of the following statements regarding IRA distributions is not correct?
a. The method of taxing IRA distributions is generally the same for California and Federal purposes
b. FTB Publication 1005 can help with any California IRA distribution questions you may have.
c. Before 1987, the maximum IRA contribution that you were allowed to deduct from California income was less than the amount allowed from Federal income.
d. You may file Form 540EZ2 or 540 if you have a Roth IRA distribution.

13. Which of the following sources of income are not taxed by California?
a. Dividends paid on California state or local obligations
b. Any California State income tax refund received.
c. U.S. Saving Bonds interest
d. All of the above

14. The following Schedule or Form is completed in order to make adjustments to your federal adjusted gross income and to your federal itemized deductions in order to figure your California Itemized deductions.
a. Schedule CA (540)
b. Schedule P (540)
c. Schedule K-1
d. Schedule D (CA)

15. Which of the following statements are true if you did not itemize deductions on your federal tax return but will itemize deductions on your California tax return?
a. Must first complete a sample federal Schedule A, Itemized Deductions.
b. Do not attach the Federal Schedule A you complete to your form 540 - it is only for informational purposes.
c. Will not need to complete Schedule CA (540).
d. All of the above are true.

16. An individual may be able to file as head of household if their child lives with them and they lived apart from their spouse/RDP during __________.
a. The entire year
b. The entire last six months of the year
c. Any six month period during the year
d. Any significant period during the year

17. For a child to qualify as a foster child for head of household purposes, which of the following must be true?
a. The child must be placed with the taxpayer by an authorized placement agency
b. The child must be placed with the taxpayer by order of a court
c. Either A or B must be true

   d. There are no specific guidelines as long as the taxpayer cared for the foster child and provided over 50% of his or her support

18. Under which of the following scenarios will Community Property status in California end? Assume all of the couples below are either married or Registered Domestic Partners (RDP) in California.

   a. Bill has taken a new job in San Francisco and is now living permanently in San Francisco. His wife, Juana, continues to live in San Diego and will join Bill in San Francisco as soon as he is able to find a new house.
   b. Joey has relocated to Oakland to take care of his sick father. His RDP Bobby continues to live separate from Joey in Los Angeles. Joey anticipates staying in Oakland for at least the next six months.
   c. Rick and Sue have separated and filed for divorce. They have no immediate intention to reconcile.
   d. Fernando and Holly have separated. They are jointly seeing a marriage counselor and have not decided on their next step concerning their marriage.

19. Which of the following are requirements for determining a taxpayers eligibility for claiming the Joint Custody Head of Household credit?

   a. You were unmarried at the end of the tax year, or if married/RDP, you lived apart from your spouse/RDP for all of the tax year and you used the married filing separate/RDP filing status.
   b. You provided more than one-half the household expenses for your home that also served as the main home of your child, step-child or grandchild for at least 146 days but not more than 219 days of the taxable year.
   c. A custody agreement for the child has not yet been approved and nothing concerning the matter has been placed in writing.
   d. Both A and B above.

20. For the 2020 tax year, which of the following taxpayers <u>is required</u> to file a California State Income Tax Return?

   a. A 26 year old single filer with no dependents with a California gross income of $11,065
   b. A 66 year old single filer with one dependent with a California gross income of $45,500
   c. A 45 year old Married Filing Joint/RDP taxpayer with two dependents, a 41 year old spouse and a California gross income of $32,036
   d. A 59 year old Qualifying Widow with one dependent and a California gross income of $25,200.

21. What is the California Standard Deduction for a Married /RDP Filing Joint taxpayer for the 2020 tax year?

   a. $4,537
   b. $4,401
   c. $9,202
   d. $1,050

22. For the 2020 tax year, which of the following taxpayers <u>is not required</u> to file a California State Income Tax Return?

a. A single filer with no dependents California adjusted gross income of $30,000
b. A 36 year old Head of Household filer with 3 dependents and a California adjusted gross income of $24,500
c. A 44 year old Married Filing Separate/RDP filer with no dependents and with California adjusted gross income of $50,500 (including RDP's income)
d. A 49 year old Single filer with two dependents and a California adjusted gross income of $44,000.

23. For the 2021 tax year, which of the following is not a due date for the payment of California estimated taxes?

a. June 15, 2021
b. September 15, 2021
c. December 15th, 2021
d. January 18, 2022

24. The exemption credit for most California taxpayer's dependents for the 2020 tax year is:

a. $383
b. $367
c. $122
d. $114

25. For the 2020 tax year California exemption credits begin to phase-out for taxpayers filing Married/RDP filing jointly if their federal AGI exceeds:

a. $200,534
b. $300,805
c. $406,687
d. California exemption credits are not limited by the FTB