

# Instructions for Schedule CA (540)

These instructions are based on the Internal Revenue Code (IRC) as of **January 1, 2005** and the California Revenue and Taxation Code (R&TC).

## What's New

**California National Guard Surviving Spouse & Children Relief Act of 2004.** Death benefits up to \$10,000 received from the state of California by a surviving spouse or member-designated beneficiary of the CA National Guard, State Military Reserve or Naval Militia personnel, who dies or is killed after March 1, 2003 in the performance of duty is not included in gross income.

**Ottoman Turkish Empire.** If you received settlement payments as a person persecuted by the regime that was in control of the Ottoman Turkish Empire from 1915 until 1923, your gross income does not include those excludable settlement payments, or interest, received by you, your heirs, or estate for payments received on or after January 1, 2005.

**Compensation of merchant seamen, military servicemembers, rail, motor, and aircraft carriers.** Compensation for the performance of duties of certain merchant seamen, rail carriers, motor carriers, aircraft carriers, and military servicemembers are not included in gross income.

## General Information

In general, California law conforms to the Internal Revenue Code (IRC) as of January 2005. However, there are continuing differences between California and federal law. When California conforms to federal tax law changes, we do not always adopt all of the changes made at the federal level. For more information regarding California and federal law, please visit our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) and search for **conformity**. Additional information can be found in FTB Pub. 1001, *Supplemental Guidelines to California Adjustments*, and the Business Entity tax booklets.

Note, the instructions provided with California tax forms are a summary of California tax law and are only intended to aid taxpayers in preparing their state income tax returns. We include information that is most useful to the greatest number of taxpayers in the limited space available. It is not possible to include all requirements of the California Revenue and Taxation Code (R&TC) in the tax booklets. Taxpayers should not consider the tax booklets as authoritative law.

**Military Personnel** – Servicemembers domiciled outside of California, and their spouses, may exclude the member's military compensation from gross income when computing the tax rate on nonmilitary income. Requirements for military servicemembers domiciled in California remain unchanged. Military servicemembers domiciled in California must include their military pay in total income. In addition, they must include their military pay in California source income when stationed in California. However, military pay is not California source income when a servicemember is permanently stationed outside of California. For more information, get FTB Pub. 1032, *Tax Information for Military Personnel*.

### Differences Between California and Federal Law for 2005:

California law does not conform to federal law for:

- The tax incentives for "renewal communities." California law does, however, provide a variety of independent area tax incentives to encourage revitalization of specially designated areas. The Government Code provides for the designation of Enterprise Zones, Local Agency Military Base Recovery Areas (LAMBRAs), a Targeted Tax Area (TTA), and Manufacturing Enhancement Areas (MEAs). California law conforms to the general federal rules for expensing IRC Section 179 property with the exception that California law only allows a maximum deduction of \$25,000. In lieu of this deduction, the California Personal Income Tax Law allows a taxpayer with a business in an "Economic Development Area" to elect to expense \$20,000 to \$40,000 (depending on the designation) of certain specified equipment used in the business.

- The increased IRC Section 179 expense. Although federal law increased the IRC Section 179 expense to \$105,000, the maximum deduction amount under California law is \$25,000.
- Rebates or vouchers received from a local water agency, energy agency, or energy supplier. This includes a rebate, voucher or other financial incentive from the California Energy Commission, the California Public Utilities Commission or a local publicly owned electric utility company for any expenses paid or incurred by a taxpayer for the purchase or installation of a thermal, solar or wind energy/fuel generating system.
- Interest deduction allowed for interest paid on any loan or indebtedness from a utility company to purchase energy efficient equipment and products for California residents.
- Net Operating Loss - Pierce's disease.
- The additional 30% or 50% first year depreciation allowance for qualified property.
- Educator Expense or the Tuition and Fees deduction.
- The Student loan interest deduction.
- The Clean Air Fuel first year deduction. You will need to report this adjustment on line 36, column B as part of your subtractions.
- Health Savings Account deductions.
- Exemption of interest on any bond or other obligation issued by the Government of American Samoa.
- Domestic production activities deduction.
- Exclusion from gross income of certain federal subsidiaries for prescription drug plans.
- Exclusion of survivor benefits attributable to service by a public safety officer who is killed in the line of duty before 1/1/1997.
- Recovery period of depreciation of certain leasehold improvements and restaurant property.

### California law is the same as federal law in the following areas:

**Roth IRAs.** The contribution rules and distribution rules are the same.  
**Self-employed health insurance deduction.** The percentage for 2005 is 100%.

**Note:** For instructions regarding registered domestic partners, see page 5, line 29.

**Holocaust Restitution Payments.** An exclusion is provided for Holocaust reparations received by eligible individuals, their heirs or estate for Holocaust restitution payments, distributions or excludable trust.

**Charitable Contributions for 2004 Tsunami Disaster.** Federal law allows a 2004 charitable contribution deduction for contributions made through January 31, 2005 for the 2004 Tsunami Disaster. As of March 11, 2005, California law conforms to federal law with regards to the 2004 Tsunami Disaster contributions. If you filed your California return prior to March 11, 2005, and reported the charitable contribution for the 2004 Tsunami disaster as a negative amount on line 40 on Schedule CA, use Form 540X, Amended Individual Income Tax Return, and report the negative amount as a positive amount on line 2e, column B.

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

## Purpose

Use this schedule to make adjustments to your federal adjusted gross income and to your federal itemized deductions using California law.

## Part I – Specific Line Instructions

### Column A — Federal Amounts

**Line 7 through Line 21** – Enter on line 7 through line 21 the same amounts you entered on your federal Form 1040, line 7 through line 21; Form 1040A, line 7 through line 14b; or Form 1040EZ line 1, line 2, and line 3.

#### Line 22 – Total

Combine the amounts on line 7 through line 21.

**Line 23 through Line 30 and line 32 through 35** – Enter the same amounts you entered on your federal Form 1040, line 23 through line 30 and line 32 through 35 or Form 1040A, line 16 through line 19.

**Line 31a and Line 31b** – Enter on line 31a the same amount you entered on your federal Form 1040, line 31a. Enter on line 31b the social security number and last name of the person to whom you paid alimony.

**Line 36** – Add line 23 through line 31a and line 32 through 35. However, if you made any of the adjustments described in the instructions for federal Form 1040, line 36 or if you claimed the foreign housing deduction from federal Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion, enter the amount from Form 1040, line 36 on this line.

#### Line 37 – Total

Subtract line 36 from line 22.

### Column B and Column C — Subtractions and Additions

Use these columns to enter subtractions and additions to the federal amounts in column A that are necessary because of differences between California and federal law. Enter all amounts as positive numbers unless instructed otherwise.

You may need one of the following FTB publications to complete column B and column C:

- 1001, *Supplemental Guidelines to California Adjustments*;
- 1005, *Pension and Annuity Guidelines*;
- 1031, *Guidelines for Determining Resident Status*;
- 1032, *Tax Information for Military Personnel*; or
- 1100, *Taxation of Nonresidents and Individuals Who Change Residency*.

To get a publication or form visit our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) or see the back cover of your tax booklet.

#### Line 7 – Wages, Salaries, Tips, etc.

Generally, you will not make any adjustments on this line. If you did not receive any of the following types of income, make no entry on this line in either column B or column C.

**Active duty military pay.** Special rules apply to active duty military taxpayers. Get FTB Pub. 1032, *Tax Information for Military Personnel*, for more information.

**Sick pay received under the Federal Insurance Contributions Act and Railroad Retirement Act.** California excludes this item from income. Enter in column B the amount of these benefits included in the amount in column A.

**Ridesharing fringe benefit differences.** Under federal law, qualified transportation benefits are excluded from gross income. Under the Revenue and Taxation Code, there are no monthly limits for the exclusion of these benefits and California's definitions are more expansive. Enter the amount of ridesharing benefits received and included in federal income on line 7, column B.

**Exclusion for Medical Expenses.** California allows an exclusion from gross income for employer-provided accident, health insurance, and medical expense reimbursement for registered domestic partners and the partner's dependents if expenses were not previously deducted.

Self-employed individuals may also claim a deduction for health insurance costs paid for themselves, their spouses, and dependents. In addition, self-employed individuals may claim this deduction for health insurance costs paid for registered domestic partner and the domestic partner's dependents. Enter the amount included in federal income in column B.

**Compensation of merchant seamen, military service members, rail, motor, and aircraft carriers.** Compensation for the performance of duties of certain merchant seamen, rail carriers, motor carriers, aircraft carriers, and military service members are not included in gross income.

**Exclusion for compensation from exercising a California Qualified Stock Option (CQSO).** To claim this exclusion, your earned income from the corporation granting the CQSO must be \$40,000 or less; the market value of the options granted to you must be \$100,000 or less; the total number of shares must be 1,000 or less; and the corporation issuing the stock must designate that the stock issued is a California qualified stock option at the time the option is granted. If you included in federal income an amount qualifying for this exclusion, enter that amount in column B.

#### Line 8 – Taxable Interest Income

If you did not receive any of the kinds of income listed below, do not make an entry on this line in either column B or column C.

Enter in column B the interest you received from:

- U.S. savings bonds (except for interest from series EE U.S. savings bonds issued after 1989 that qualified for the Education Savings Bond Program exclusion);
- U.S. Treasury bills, notes, and bonds; or
- Any other bonds or obligations of the United States and its territories.
- Interest earned from Ottoman Turkish Empire Settlement Payments.

Enter in column C the interest you identified as tax-exempt interest on your federal Form 1040 (or Form 1040A), line 8b, **and** which you received from:

- Non-California state bonds;
- Non-California municipal bonds issued by a county, city, town, or other local government unit;
- Obligations of the District of Columbia issued after 12/27/73;
- Non-California bonds if the interest was passed through to you from S corporations, trusts, partnerships, or Limited Liability Companies (LLCs).
- Interest or other earnings earned from a Health Savings Account (HSA) are not treated as taxed deferred. Interest or earnings in a HSA are taxable in the year earned.
- Interest on any bond or other obligation issued by the Government of American Samoa.

**Note: Do not** make entries in either column B or column C for interest you earned on Federal National Mortgage Association (Fannie Mae) Bonds, Government National Mortgage Association (Ginnie Mae) Bonds, and Federal Home Loan Mortgage Corporations (FHLMC) securities, or grants paid to low income individuals.

Get FTB Pub. 1001, *Supplemental Guidelines to California Adjustments* if you received interest income from the following sources:

- Loans made in an enterprise zone (EZ); or
- Items listed above passed through to you from S corporations, trusts, partnerships, or LLCs.

#### Line 9 – Ordinary dividends

Generally, you will not have a difference between the amount of dividends reported in Column A and the amount reported using California law. However, California taxes dividends that are derived from other states and their municipal obligations. In addition, certain mutual funds pay "exempt-interest dividends". If the mutual fund has at least 50% of its assets invested in tax-exempt U.S. obligations and/or in California or its municipal obligations, that amount of dividend is exempt from California tax. The proportion of dividends that are tax-exempt will be shown on your annual statement or statement issued with Form 1099-DIV.

Add dividends received from the following and enter in column B:

- The portion of exempt interest dividends from mutual funds that meets the 50% rule above and were included in column A.
- Non-cash patronage dividends from farmers' cooperatives or mutual associations.

Add dividends received from the following and enter in column C:

- The federally exempt interest dividends from other states, or their municipal obligations and/or from mutual funds that do not meet the 50% rule above.
- Controlled foreign corporation dividends in the year distributed;
- Regulated investment company (RIC) capital gains in the year distributed;
- Distributions of pre-1987 earnings from an S corporation;
- Non-cash patronage dividends from farmers' cooperatives or mutual associations.

Get FTB Pub. 1001, *Supplemental Guidelines to California Adjustments* if you received dividends from:

- Non-cash patronage dividends from farmers' cooperatives or mutual associations;
- A controlled foreign corporation;
- Distributions of pre-1987 earnings from S corporations; or
- Undistributed capital gains for regulated investment company (RIC) shareholders.

#### **Line 10 – Taxable refunds, credits, or offsets of state and local income taxes**

California does not tax the state income tax refund you received in 2005. Enter in column B the amount of state tax refund you entered in column A.

#### **Line 11 – Alimony Received**

If you are a nonresident alien and received alimony that was not included in your federal income, enter the alimony on this line in column C. Otherwise, make no entry on this line.

#### **Line 12 – Business Income or (Loss)**

Adjustments to federal business income or loss you reported in column A generally are necessary because of the difference between California and federal law relating to depreciation methods, special credits, and accelerated write-offs. As a result, the recovery period or basis you use to figure California depreciation may be different from the amount used for federal purposes.

Adjustments are figured on form FTB 3885A, Depreciation and Amortization Adjustments, and are most commonly necessary because of the following:

- **Before January 1, 1987**, California did not allow depreciation under the federal accelerated cost recovery system. You must continue to figure California depreciation for those assets in the same manner as prior years.
- **On or after January 1, 1987**, California provides special credits and accelerated write-offs that affect the California basis of qualifying assets. Refer to the bulleted list below.

Use form FTB 3801, Passive Activity Loss Limitations, to figure the total adjustment for line 12 if you have:

- One or more passive activities that produce a loss; or
- One or more passive activities that produce a loss **and** any nonpassive activity reported on federal Schedule C.

Use form FTB 3885A to figure the total adjustment for line 12 if you have:

- Only nonpassive activities which produce either gains or losses (or combination of gains and losses); or
- Passive activities that produce gains.

Get FTB Pub. 1001, *Supplemental Guidelines to California Adjustments* for more information about:

#### **Income related to:**

- Business, trade, or profession carried on within California that is an integral part of a unitary business carried on both within and outside California; or
- Pro-rata share of income received from a controlled foreign corporation by a U.S. shareholder.

#### **Basis adjustments related to:**

- Property acquired prior to becoming a California resident;
- Sales or use tax credit for property used in an EZ, Local Agency Military Base Recovery Area (LAMBRA), Targeted Tax Area (TTA), or former LARZ;

- Reduced recovery periods for fruit-bearing grapevines replaced in a California vineyard on or after 1/1/92 as a result of phylloxera infestation; or on or after 1/1/97 as a result of Pierce's disease;
- Expenditures for tertiary injectants;
- Property placed in service on an Indian reservation after 1/1/94 and before 1/1/05;
- Amortization of pollution control facilities;
- Discharge of real property business indebtedness;
- Employer-paid child care program;
- Employer-paid child care plan;
- Vehicles used in an employer-sponsored ridesharing program;
- An enhanced oil recovery system;
- Joint Strike Fighter property costs;
- The cost of making a business accessible to disabled individuals;
- Property for which you received an energy conservation subsidy from a public utility on or after 1/1/95 and before 1/1/97; or
- Research and experimental expenditures.

#### **Business expense deductions related to:**

- Wages paid in an EZ, LAMBRA, Manufacturing Enhancement Area (MEA), or TTA;
- Certain employer costs for employees who are also enrolled members of Indian tribes;
- Abandonment or tax recoupment fees for open-space easements and timberland preserves;
- Business located in an EZ, LAMBRA, or TTA;
- Research expense;
- Employer wage expense for the Work Opportunity Credit and Welfare-to-Work Credit;
- Pro-rata share of deductions received from a controlled foreign corporation by a U.S. shareholder;
- Interest paid on indebtedness in connection with company-owned life insurance policies; or
- Premiums paid on life insurance policies, annuities, or endowment contracts issued after 6/8/97 where the owner of the business is directly or indirectly a policy beneficiary.

#### **Line 13 – Capital Gain or (Loss)**

Generally, you will not make an adjustment on this line. California taxes long and short term capital gains as regular income. There is no special rate for long term capital gains. However, the California basis of the assets listed below may be different from the federal basis due to differences between California and federal laws. If there are differences, use Schedule D (540), California Capital Gain or Loss Adjustment, to calculate the amount to enter on this line.

- Gain on the sale of qualified small business stock which qualifies for the gain exclusion under IRC Section 1202;
- Basis amounts resulting from differences between California and federal law in prior years;
- Gain or loss on stock and bond transactions;
- Installment sale gain reported on form FTB 3805E, Installment Sale Income;
- Gain on the sale of personal residence where depreciation was allowable;
- Flow-through gain or loss from partnerships, fiduciaries, S corporations, or LLCs; or
- Capital loss carryover from your 2004 California Schedule D (540).

Get FTB Pub. 1001, *Supplemental Guidelines to California Adjustments* for more information about:

- Disposition of S corporation stock acquired before 1987;
- Gain on sale or disposition of qualified assisted housing development to low-income residents or to specified entities maintaining housing for low-income residents;
- Undistributed capital gain for RIC shareholders;
- Gain or loss on the sale of property inherited before 1/1/87; or
- Capital loss carrybacks.

#### **Line 14 – Other Gains or (Losses)**

Generally, you will not make any adjustments on this line. However, the California basis of your other assets may be different from the federal basis due to differences between California and federal law. Therefore,



you may have to adjust the amount of other gains or losses. Get Schedule D-1, Sales of Business Property.

#### **Line 15 – Total IRA Distributions**

Generally, you will not make any adjustments on this line. However, there may be significant differences in the taxable amount of a distribution (including a distribution from conversion of a traditional IRA to a Roth IRA), depending on when you made your contributions to the IRA. Differences may also occur if your California IRA deductions were different from your federal deductions because of differences between California and federal self-employment income.

If the taxable amount using California law is:

- Less than the amount taxable under federal law, enter the difference in column B; or
- More than the amount taxable under federal law, enter the difference in column C.

Get FTB Pub. 1005 for more information and worksheets for figuring the adjustment to enter on this line, if any.

**Caution:** If you have an IRA basis and were a nonresident in prior years, you may need to restate your California IRA basis. Get FTB Pub. 1100, *Taxation of Nonresidents and Individuals Who Change Residency*.

**Coverdell ESA formerly known as Education (ED) IRA** – If column A includes a taxable distribution from an ED IRA, you may owe additional tax on that amount. Get form FTB 3805P, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts. Report only the taxable amount of the distribution on line 21f.

#### **Line 16 – Total Pensions and Annuities**

Generally, you will not make any adjustments on this line. However, if you received Tier 2 railroad retirement benefits or partially taxable distributions from a pension plan, you may need to make the following adjustments.

If you received a federal Form RRB 1099-R for railroad retirement benefits and included all or part of these benefits in taxable income in column A, enter the taxable benefit amount in column B.

If you began receiving a retirement annuity between 7/1/86 and 1/1/87 and elected to use the three-year rule for California purposes and the annuity rules for federal purposes, enter in column C the amount of the annuity payments you excluded for federal purposes.

**Caution:** You may have to pay an additional tax if you received a taxable distribution from a qualified retirement plan before reaching age 59½ and the distribution was not rolled over into another qualified plan. See Form 540, line 36 instruction; or Form 3805P, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.

#### **Line 17 – Rental Real Estate, Royalties, Partnerships, S Corporations, and Trusts, etc.**

Adjustments to federal income or loss you reported in column A generally are necessary because of the difference between California and federal law relating to depreciation methods, special credits, and accelerated write-offs. As a result, the recovery period or basis you use to figure California depreciation may be different from the recovery period or amount used for federal purposes, and you may need to make an adjustment to your income or loss. For more information, see the instructions for column B and column C, line 12.

**Note:** California law does not conform to federal law for material participation in rental real estate activities. Beginning in 1994, and for federal purposes only, rental real estate activities conducted by persons in real property business are not automatically treated as passive activities. Get form FTB 3801, Passive Activity Loss Limitations, for more information.

Use form FTB 3801, Passive Activity Loss Limitations, to figure the total adjustment for line 17 if you have:

- One or more passive activities that produce a loss; or
- One or more passive activities that produce a loss **and** any nonpassive activity reported on federal Schedule E.

Use form FTB 3885A, Depreciation and Amortization Adjustments, to figure the total adjustment for line 17 if you have:

- Only nonpassive activities which produce either gains or losses (or combination of gains and losses); or
- Passive activities that produce gains.

**Note:** LLCs that are classified as partnerships for California purposes and limited liability partnerships (LLPs) are subject to the same rules as other partnerships. LLCs report distributive items to members on Schedule K-1 (568), Member's Share of Income, Deductions, Credits, etc. LLPs report to partners on Schedule K-1 (565), Partner's Share of Income, Deductions, Credits, etc.

Get FTB Pub. 1001, *Supplemental Guidelines to California Adjustments* for more information about accumulation distributions to beneficiaries for which the trust was not required to pay California tax because the beneficiary's interest was contingent.

#### **Line 18 – Farm Income or (Loss)**

Adjustments to federal income or loss you report in column A generally are necessary because of the difference between California and federal law relating to depreciation methods, special credits, and accelerated write-offs. As a result, the recovery period or basis you use to figure California depreciation may be different from the amount used for federal purposes, and you may need to make an adjustment to your farm income or loss.

Use form FTB 3801, Passive Activity Loss Limitations, to figure the total adjustment for line 18 if you have:

- One or more passive activities that produce a loss; or
- One or more passive activities that produce a loss **and** any nonpassive activity reported on federal Schedule F.

Use form FTB 3885A, Depreciation and Amortization Adjustments, to figure the total adjustment for line 18 if you have:

- Only nonpassive activities which produce either gains or losses (or combination of gains and losses); or
- Passive activities that produce gains.

#### **Line 19 – Unemployment Compensation**

California does not tax unemployment compensation. Enter on line 19, column B the amount of unemployment compensation shown in column A.

**Paid Family Leave Insurance (PFL) benefits, also known as Family Temporary Disability Insurance.** If you received payments from the PFL Program in 2005, enter the amount reported on your Form 1099-G in Column B, line 19. For additional information, get FTB Pub. 1001, *Supplemental Guidelines to California Adjustments*.

#### **Line 20 – U.S. Social Security Benefits**

California does not tax U.S. social security benefits or equivalent Tier 1 railroad retirement benefits. Enter in column B the amount of U.S. social security benefits or equivalent Tier 1 railroad retirement benefits shown in column A.

#### **Line 21 – Other Income**

**a. California Lottery Winnings.** California does not tax California lottery winnings. Enter in column B the amount of California lottery winnings included in the federal amount on line 21 in column A.

**Note:** Do not make an adjustment for lottery winnings from other states. They are taxable by California. California and federal laws allow gambling losses only to the extent of reported gambling income. If you reduced your gambling income for California lottery income, you may need to reduce the losses included in the federal itemized deductions on line 38. Enter these losses on line 41 as a negative number.

**b. Disaster Loss Carryover from form FTB 3805V, Part III, line 6.** If you have a California disaster loss carryover from your 2004 form FTB 3805V, Net Operating Loss (NOL) Computation and NOL and Disaster Loss Limitations – Individuals, Estates, and Trusts, enter that amount as a positive number in column B.

**c. Federal NOL deduction from Form 1040, line 21.** If the amount on line 21 in column A includes a federal NOL, enter the amount of the federal NOL deduction as a positive number in column C. Get form FTB 3805V, Net Operating Loss (NOL) Computation and NOL and

Disaster Loss Limitations – Individuals, Estates, and Trusts, to figure the allowable California NOL deduction.

**d. NOL Carryover from form FTB 3805V, Part III, line 5.** The allowable NOL carryover under California law is different from the allowable NOL carryover under federal law. Use form FTB 3805V to figure the allowable California NOL deduction and enter it as a positive number in column B.

**e. NOL deduction from form FTB 3805D, FTB 3805Z, FTB 3806, FTB 3807, or FTB 3809.** Enter in column B the total NOL deduction figured on the following forms.

- FTB 3805D, Net Operating Loss (NOL) Computation and Limitation – Pierce’s Disease;
- FTB 3805Z, Enterprise Zone Deduction and Credit Summary, line 5b;
- FTB 3806, Los Angeles Revitalization Zone Deduction and Credit Summary, line 3b;
- FTB 3807, Local Agency Military Base Recovery Area Deduction and Credit Summary, line 5b; or
- FTB 3809, Targeted Tax Area Deduction and Credit Summary, line 3b.

**f. Other (describe)**

**Reward from a crime hotline.** Enter in column B the amount of a reward authorized by a government agency that you received from a crime hotline established by a government agency or nonprofit organization and that is included in the amount on line 21 in column A.

**Note:** You may not make this adjustment if you are an employee of the hotline or someone who sponsors rewards for the hotline.

**Federal foreign earned income or housing exclusion.** Enter in column C the amount deducted from federal income on Form 1040, line 21.

**Beverage container recycling income.** Enter in column B the amount of this type of income that you included in the amount on line 21 in column A.

**Rebates or vouchers from a local water agency, energy agency, or energy supplier.** California law allows an income exclusion for rebates or vouchers from a local water agency, energy agency, or energy supplier for the purchase and installation of water conservation appliances and devices. Enter in column B the amount of this type of income that you included in the amount on line 21 in column A.

**Original issue discount (OID) for debt instruments issued in 1985 and 1986.** In the year of sale or other disposition, you must recognize the difference between the amount reported on your federal return and the amount reported for California purposes. **Issuers:** Enter the difference between the federal deductible amount and the California deductible amount on line 21f in column B. **Holders:** Enter the difference between the amount included in federal gross income and the amount included for California purposes on line 21f in column C.

**Foreign income of nonresident aliens.** Adjust federal income to reflect worldwide income computed under California law. Enter losses from foreign sources in column B. Enter foreign source income in column C.

**Cost-share payments received by forest landowners.** Enter in column B the cost-share payments received from the Department of Forestry and Fire Protection under the California Forest Improvement Act of 1978 or from the United States Department of Agriculture, Forest Service, under the Forest Stewardship Program and the Stewardship Incentives Program, pursuant to the Cooperative Forestry Assistance Act.

**Compensation for False Imprisonment.** California excludes compensation for false imprisonment from income. Enter the amount of compensation on line 21f, column B.

**Coverdell (ESA) Distributions.** If you received a distribution from a Coverdell ESA, report only the taxable amount of the distribution on line 21f.

**Health Savings Account (HSA) Distributions for unqualified medical expense.** Distributions from a HSA not used for qualified medical expenses, and included in federal income, are not taxable for California purposes. Enter the distribution not used for qualified medical expenses on line 21f, column B.

**Grants paid to low-income individuals.** California excludes grants paid to low-income individuals to construct or retrofit buildings to make them more energy efficient. Federal has no similar exclusion. Enter on line 21f, column B the amount of this type of income.

**California National Guard Surviving Spouse & Children Relief Act of 2004.** Death benefits received from the State of California (\$10,000) to the surviving spouse or member-designated beneficiary of certain military personnel killed in the performance of duty is not gross income. Military personnel include the California National Guard, State Military Reserve, or the Naval Militia. If you reported a death benefit on line 21, column A, enter the death benefit amount in column B.

**Ottoman Turkish Empire Settlement Payments.** Gross income does not include settlement payments received by an eligible individual, individual heirs or estate, as a person persecuted by the regime that was in control of the Ottoman Turkish Empire from 1915 until 1923. If you reported settlement payments on line 21, column A, enter the amount of settlement payments in column B.

**Foreign Income.** If you excluded income exempted by U.S. tax treaties on your federal Form 1040 (unless specifically exempt for state purposes), enter the excluded amount in Column C. If you claimed foreign earned income or housing cost exclusion on your federal Form 1040 (under IRC Section 911), see the instructions for line 21.

**Line 22 – Total**

Add line 7 through line 21f in column B and column C. Enter the totals on line 22.

**Line 23 through Line 31a and line 32 through line 35** – California law is the same as federal law with the exception of the following:

- Line 23 (Educator expense) – transfer the amount from column A, line 23, to column B, line 23.
- Line 24 (Certain business expenses of reservists, performing artists, and fee-basis government officials) - If you are claiming a depreciation deduction as an unreimbursed employee business expense on Form 2106, you may have an adjustment in column B or column C.
- Line 25 (Health Savings Account Deduction) – Federal law allows a deduction for contributions to an HSA account. California does not conform to this provision. Transfer the amount from Column A, line 25, to column B, line 25.
- Line 29 (Self-Employed Health Insurance Deduction) – most people do not have any entry in column B or column C. For the purposes of this deduction, California allows you to treat your registered domestic partner as your spouse.

Enter on line 29, column C, the amount paid for health insurance coverage (established under your business) for your registered domestic partner and their dependents. Your total California deduction cannot exceed the limitations explained in the federal instructions. Do not include health insurance costs for any month you were eligible to participate in any subsidized health plan maintained by you or your domestic partner’s employer.

Enter on line 29, column B, the amount of health insurance cost included in column A, line 29, for any month you were eligible to participate in any subsidized health plan maintained by your registered domestic partner’s employer.

- Line 31a (Alimony Paid) – Enter the social security number and last name of the person to whom you paid alimony.

**Note:** If you are a nonresident alien and did not deduct alimony on your federal return, enter the amount you paid in column C.

- Line 32 (IRA Deduction) – If you are an active duty military member domiciled outside of California, you may have an adjustment. See line 36.
- Line 33 (Student Loan Interest Deduction) – California only allows a deduction for interest required to be paid in the first 60 months. California also has a different phase-out deduction amount. If you claimed the student loan interest deduction on your federal return, complete the worksheet on next page to compute the amount to enter on line 33.

- Line 34 (Tuition and Fees deduction) – transfer the amount from column A, line 34, to column B, line 34.
- Line 35 – California does not conform to the federal law regarding the Domestic production activities deduction. If you made an adjustment on your federal return for Domestic production activities, enter that amount in column B.

**Student Loan Interest Deduction Worksheet**

1. Enter the total amount from Schedule CA, (540), line 33, Column A . . . . . 1. \_\_\_\_\_
- Caution:** If the amount on line 1 is zero. STOP. Enter zero on Schedule CA (540), line 33, column B. You are not allowed a deduction for California.
2. Enter the total interest you paid in 2005 on qualified student loans. Do not include interest that was required to be paid after the first 60 months or interest for voluntary payments . . . 2. \_\_\_\_\_
  3. Enter the smaller of line 2 or \$2,500 . . . . . 3. \_\_\_\_\_
  4. Enter the amount from Form 540, line 13 (**Note:** Use the federal AGI NOT California AGI) . . . . . 4. \_\_\_\_\_
  5. Add line 1 and line 4 . . . . . 5. \_\_\_\_\_
  6. Did you file federal Form 2555, 2555-EZ, or 4563, or are you excluding income from sources within Puerto Rico or American Samoa from your federal income?
    - No.** Skip line 6a through 6d. Enter the amount from line 5 on line 7 and go to line 8.
    - Yes.** Continue to line 6a.
  - 6a. Enter any foreign earned income exclusion (federal Form 2555, line 40 or Form 2555-EZ, line 18) 6a. \_\_\_\_\_
  - 6b. Enter any housing exclusion and/or deduction (federal Form 2555, line 34 and line 48) . . . . . 6b. \_\_\_\_\_
  - 6c. Enter the amount of income from Puerto Rico that you are excluding from federal income . . . . . 6c. \_\_\_\_\_
  - 6d. Enter the amount of income from American Samoa that you are excluding (federal Form 4563, line 15) . . . . . 6d. \_\_\_\_\_
  7. Add line 5 through line 6d . . . . . 7. \_\_\_\_\_
  8. Enter the amount shown below for your filing status
    - Single, head of household, or qualifying widow(er) – \$40,000
    - Married filing jointly – \$60,000
 } 8. \_\_\_\_\_
  9. Is the amount on line 7 more than the amount on line 8?
    - No.** Skip lines 9 and 10, enter -0- on line 11, and go to line 12.
    - Yes.** Subtract line 8 from line 7 9. \_\_\_\_\_
  10. Divide line 9 by \$15,000. Enter the result as a decimal (rounded to at least three places). Do not enter more than "1.000" . . . . . 10. \_\_\_\_\_
  11. Multiply line 3 by line 10 . . . . . 11. \_\_\_\_\_
  12. Student loan interest deduction. Subtract line 11 from line 3 . . . . . 12. \_\_\_\_\_
  13. Student loan interest adjustment. Subtract line 12 from line 1. Enter the result here and on Schedule CA (540), line 33, column B . . . . . 13. \_\_\_\_\_

that amount in the total you enter in column B, line 36. Enter the amount and "Clean Fuel" on the dotted line next to line 36. If you claimed the foreign housing deduction, include that amount in the total you enter in column B, line 36. Enter the amount and "Form 2555" or "Form 2555-EZ" on the dotted line next to line 36. If you're an active duty military and you're not domiciled in California and your IRA deduction was limited because of a federal AGI limitation, recalculate your deduction excluding your active duty military pay. If the recalculated amount is larger than the amount on line 32, column A, enter the difference between the two amounts in Column C, line 36. Enter the amount and "MPA Adjustment" on the dotted line next to line 36.

**Line 37 – Total**

Subtract line 36 from line 22 in column B and column C.

Also, transfer the amount from:

- Line 37, column B to Form 540, Side 1, line 14

**Caution:** If column B is a negative number, transfer the amount as a positive number to line 16.

- Line 37, column C to Form 540, Side 1, line 16

**Caution:** If column C is a negative number, transfer the amount as a positive number to line 14.

**Note:** If you plan to itemize deductions, go to Part II.

**Part II – Specific Line Instructions**

**Line 38 – Federal Itemized Deductions**

Enter the total amount of itemized deductions from your federal Form 1040, Schedule A, lines 4, 9, 14, 18, 19, 26, and 27. **Important:** If you did not itemize deductions on your federal tax return but will itemize deductions on your California tax return, first complete federal Schedule A. Then complete Schedule CA (540), Part II, line 38 through line 44.

**Line 39 – State, Local, Foreign Income Taxes, and General Sales Tax**

Enter the state and local income tax from federal Form 1040, Schedule A, line 5 and only the portion relating to foreign income taxes from line 8. Include state disability insurance (SDI), limited partnership tax, and income or franchise tax paid by S corporations.

If you are deducting general sales taxes on your federal Schedule A, line 5, enter this amount on Schedule CA, line 39.

**Note:** For tax years beginning in 2004 and 2005, the American Jobs Creation Act of 2004 allows taxpayers to elect to claim state and local general sales and use taxes as an itemized deduction, instead of claiming an itemized deduction for state and local income taxes. The Act gives taxpayers a choice of deducting actual taxes or a tabular amount, increased by certain actual taxes. California has not conformed to this Act.

**Line 41 – Other Adjustments**

**Adoption-Related Expenses.** If you deducted adoption-related expenses on your federal Form 1040, Schedule A and are claiming the adoption cost credit for the same amounts on your Form 540, enter the amount of the adoption cost credit claimed as a negative number on line 41.

**Mortgage Interest Credit.** If you reduced your federal mortgage interest deduction by the amount of your mortgage interest credit (from federal Form 8396, Mortgage Interest Credit), increase your California itemized deductions by the same amount. Enter the amount of your federal mortgage interest credit as a positive number on line 41.

**Nontaxable Income Expenses.** If, on federal Schedule A, you claim expenses related to producing income taxed under federal law but not taxed by California, enter the amount as a negative number on line 41. You may claim expenses related to producing income taxed by California law but not taxed under federal law by entering the amount as a positive number on line 41.

**Employee Business Expense.** If you completed federal Form 2106, Employee Business Expense, or Form 2106-EZ, Unreimbursed Employee Business Expense, prepare a second set of forms reflecting your

**Line 36 –** Add line 23 through line 31a and line 32 through line 35 in column B and column C. If you claimed the clean fuel deduction, include

employee business expense using California amounts (i.e., following California law).

Compare lines 10 on the federal form and the form completed using California amounts. If the federal amount is larger, enter the difference as a negative number on line 41 (bracket the number). If the California amount is larger, enter the difference as a positive number on line 41.

**Investment Interest Expense.** Your California deduction for investment interest expense may be different from your federal deduction. You must use form FTB 3526, Investment Interest Expense Deduction, to figure the amount to enter on line 41.

**Interest Expense Deduction.** Your California interest expense deduction may be different from your federal deduction. A deduction is allowed for interest paid on any loan or financed indebtedness from a utility company to purchase energy efficient equipment and products for California residences. Enter as a positive number on line 41.

**Gambling Losses.** California lottery losses are not deductible for California. Enter the amount of California lottery losses shown on federal Schedule A as a negative number on line 41.

**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 as a negative number on line 41.

**Generation Skipping Transfer Tax.** Tax paid on generation skipping transfers is not deductible under California law. Enter the amount of expenses shown on federal Schedule A as a negative number on line 41.

**State Legislator's Travel Expenses.** Under California law, deductible travel expenses for state legislators include only those incurred while away from their place of residence overnight. Figure the difference between the amount allowed using federal law and the amount allowed using California law. Enter the difference as a negative number on line 41.

**Health Savings Account (HSA) Distributions** – If you received a tax-free HSA distribution for qualified medical expenses, enter the qualified expenses paid that exceed 7.5% of federal AGI as an adjustment to itemized deductions. To determine the amount of the itemized deduction adjustment:

- Calculate the medical expense deduction for California.
- Calculate the medical expense deduction for federal.
- Subtract the federal amount from the California amount. Enter the amount on line 41, as a positive amount.

**Charitable Contribution Carryover Deduction.** If you are deducting a prior year charitable contribution carryover, and the California carryover is larger than the federal carryover, enter the additional amount as a positive number on line 41.

**Carryover Deduction Appreciated Stock Contributed to a Private Foundation prior to 1/1/02.** If you are deducting a charitable contribution carryover of appreciated stock donated to a private operating foundation prior to 1/1/02, and the fair market value allowed for federal purposes is larger than the basis allowed for California purposes, enter the difference as a negative number on line 41.

**Interest on loans from utility companies.** Taxpayers are allowed a tax deduction for interest paid or incurred on a public utility company financed loan that is used to purchase and install energy efficient equipment or products, including zone-heating products for a qualified residence **located in California**. Federal law has no equivalent deduction. Enter the amount as a positive number on line 41.

**Medical benefits paid on behalf of registered domestic partners.** Taxpayer benefits are extended to include the taxpayer's registered domestic partner and their dependent(s) for medical expenses and health insurance benefits that occur on or after 1/1/02. Federal law does not include this provision. Enter the amount as a positive number on line 41.

**Claim of Right.** If you claimed a credit for the repayment on your federal return and are deducting the repayment for California, enter the

allowable deduction, as a positive amount on Schedule CA, line 41. Deductions of \$3,000 or less are subject to the 2% federal AGI limit. If you deducted the repayment on your federal return and are taking a credit for California, enter the amount of the federal deduction as a negative amount on Schedule CA, line 41.

To help you determine whether to take a credit or deduction, see the Repayment section of federal Publication 525, Taxable and Nontaxable Income. Remember to use the California tax rate in your computations. If you choose to take the credit instead of the deduction for California, add the credit amount on line 46, the total payment line of Form 540. To the left of the total, write "IRC 1341" and the amount of the credit.

#### Line 43 – California Itemized Deductions

Is the amount on Form 540, line 13 more than the amount shown below for your filing status?

Single or married filing separately ..... \$143,839  
Married filing jointly or qualifying widow(er) ..... \$287,682  
Head of household ..... \$215,762

**NO** Transfer the amount from line 42 to line 43. Do not complete the worksheet.

**YES** Complete the Itemized Deductions Worksheet.

#### Note:

- If you are married and filing a separate return, you and your spouse must either both itemize your deductions or both take the standard deduction.
- Also, if someone else can claim you as a dependent, you may claim the greater of the standard deduction or your itemized deductions. See instructions for the "California Standard Deduction Worksheet for Dependents" to figure your standard deduction.

#### Itemized Deductions Worksheet

1. Amount from Schedule CA (540), line 42 .....	1 _____
2. Using California amounts, add the amounts on federal Form 1040, Schedule A, line 4, line 13, and line 19 plus any gambling losses included on line 27 .....	2 _____
3. Subtract line 2 from line 1 .....	3 _____
<b>Note:</b> If -0-, stop. Enter the amount from line 1 on Schedule CA (540), line 43.	
4. Multiply line 3 by 80% (.80) .....	4 _____
5. Amount from Form 540, line 13 .....	5 _____
6. Enter the amount shown above for your filing status ..	6 _____
7. Subtract line 6 from line 5 .....	7 _____
<b>Note:</b> If -0- or less, stop. Enter the amount from line 1 on Schedule CA (540), line 43.	
8. Multiply line 7 by 6% (.06) .....	8 _____
9. Compare line 4 and line 8. Enter the smaller amount here .....	9 _____
10. Total itemized deductions. Subtract line 9 from line 1. Enter here and on Schedule CA (540), line 43 .....	10 _____