

General Information

Changes to Note

In general, California tax law conforms to the Internal Revenue Code (IRC) as of January 1, 1998. However, there are continuing differences between California and federal tax law. California has not conformed to the changes made to the IRC by the federal Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (Public Law 105-206) and the Tax and Trade Relief Extension Act of 1998 (Public Law 105-277).

Roth IRAs

Under a Roth IRA, contributions are not deductible, earnings are excludable and all qualified distributions are excluded from income. In general, California conforms to the federal rules coordinating annual contribution limits between regular IRAs and Roth IRAs, conversion of regular IRA to Roth IRA, permissible rollovers, income phase-out limits and treatment of distributions (see General Information D on page 2). Get federal Form 8606, Nondeductible IRAs (Contributions, Distributions, and Basis), for more information.

Education (Ed) IRAs

Under the Ed IRA, contributions are not deductible, earnings are excludable and distributions are not taxable if used for qualified educational expenses. In general, California conforms to the federal rules regarding contribution limits, income phaseout limits and the treatment of distributions. Get federal Form 8606 for more information. If you have a taxable distribution from an Ed IRA, get form FTB 3805P, Additional Taxes Attributable to IRAs, Other Qualified Retirement Plans, Annuities, Modified Endowment Contracts, and MSAs, to figure the additional tax.

Medical Savings Accounts (MSAs)

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

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

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

A Purpose

This publication explains the most common differences between California and federal law with regard to pensions and annuities and how to report these differences on your California income tax return. It also provides information

about IRAs, Roth IRAs, Keoghs, SEPs and Savings Incentive Match (SIMPLE) Plans.

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

Common terms used in this publication are:

AGI	– Adjusted Gross Income
Form 540A	– California Resident Income Tax Return
Form 540	– California Resident Income Tax Return
Form 540NR	– California Nonresident or Part-Year Resident Income Tax Return
Schedule CA (540)	– California Adjustments — Residents
Schedule CA (540NR)	– California Adjustments — Nonresidents or Part-Year Residents

The differences between federal and California AGI are reported as adjustments on:

- Schedule CA (540) for Form 540 filers;
- Schedule CA (540NR) for Form 540NR filers; and
- Form 540A, Side 2, Part I, for Form 540A filers.

B Social Security and Railroad Retirement Benefits

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

- Social security benefits;
- Social security equivalent benefit (SSEB) portion of tier 1 railroad retirement benefits;
- Non-SSEB portion of tier 1 railroad retirement benefits; and
- Tier 2 railroad retirement benefits and sick pay benefits under the Railroad Unemployment Insurance Act.

You must make an adjustment to exclude this income if any of the benefits listed above were included in your federal AGI. See the instructions for Schedule CA (540 or 540NR), line 7, line 16 and line 20b, or Form 540A, Side 2, Part I for more information.

C Pension and Annuity Income

The California treatment of pension and annuity income is generally the same as the federal treatment. For example, California and federal law are the same regarding the "General Rule," the "Simplified General Rule" (sometimes called the "Safe Harbor Method"), rollovers and the lump-sum credit received by federal employees.

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

Exception: You may reduce the taxable portion of your pension by the amount of interest from bonds purchased through a qualified bond purchase plan as described in IRS Pub. 590, Individual Retirement Arrangements (IRAs) (Including SEP-IRAs and SIMPLE IRAs).

For information on the federal treatment of pensions and annuities, refer to federal Pub. 575, Pension and Annuity Income, federal Pub. 721, Tax Guide to U.S. Civil Service Retirement Benefits, or federal Pub. 939, General Rule for Pensions and Annuities.

Three-Year Rule

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

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

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

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

Form 540A Filers. Enter the difference in parentheses on Form 540A, Side 2, Part I, line 6 and follow the instructions for Form 540A.

Nonresidents of California Receiving a California Pension

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

- A qualified plan described in 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 individual retirement arrangement 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); or
- A private deferred compensation plan program or arrangement described in IRC Section 3121(v)(2)(C) **only** if the income is:
 1. Part of a series of substantially equal periodic payments (not less frequently than

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

Retirement income includes any retired or retainer pay received by a member or former member of a uniform service computed under Chapter 71 of Title 10, United States Code.

California **does** impose tax on retirement income received before 1/1/96, by a nonresident from sources within California. Retirement income has a source within California if the services that gave rise to the income were performed in this state.

Military Pension. As a nonresident of California, you are not taxed on your military pension received after 12/31/95.

A military pension received by a nonresident prior to 1/1/96 is taxable by California to the extent the pension has a California source. The military pension has a California source for the portion of time you served in California **only** if you were a California resident. Get FTB Pub. 1032, Tax Information for Military Personnel.

Residents of California Receiving an Out-of-State Pension

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

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

Determination: You are a full-year resident of California. As a California resident, you are taxed on all your income, regardless of its source. Therefore, the amount taxable for California purposes is \$10,000, even though a portion of the pension is for the services you performed in Texas. **Do not** make an adjustment on Schedule CA (540), or Form 540A, Side 2, Part I to exclude any of the pension from your income.

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

Determination: You are a full-year resident of California. As a California resident, you are taxed on all your income, regardless of its source. Therefore, your pension is taxable by California, even though the pension has a New York source. **Do not** make an adjustment on Schedule CA (540), or Form 540A, Side 2, Part I to exclude your New York pension from your income.

Example 3 — In December 1997, you retired and moved permanently to California. Prior to your move, you elected to receive your pension

as a lump-sum distribution. Your pension is attributable solely to services you performed in Washington prior to your move. You received the lump-sum distribution in February 1998, after you became a California resident. The taxable amount of the lump-sum distribution for federal purposes is \$80,000.

Determination: You are a full-year California resident in 1998. As a California resident, you are taxed on all income, regardless of its source. Although the lump-sum distribution is attributable to services you performed in Washington, the full \$80,000 is taxable by California because you were a resident when you received the distribution.

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

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

Military Pension. A California resident is taxed on all income, regardless of source. Therefore, a military pension received by a California resident is taxable by California, regardless of where the military service was performed.

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

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

D Roth IRA

The California treatment of Roth IRAs is generally the same as the federal treatment. Refer to federal Form 8606, Nondeductible IRAs, for the definition of a Roth IRA. However, there are some specific differences between federal and California law since California did not conform to the technical corrections made to the IRC by the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206). As a result, California does not allow:

- The accelerated income inclusion election for conversions from traditional IRA to Roth IRA which allows you to elect to report the entire taxable gain in 1998. For California purposes, the taxable gain must be spread over four years.

- The exception which allows a surviving spouse beneficiary to treat the remaining amounts as includible in income in the same manner that the deceased spouse would have included them. For California purposes, the remaining amounts are includible as income on the final return of the deceased spouse.

Get FTB Pub. 1005A, California Tax Treatment of Roth IRA for more information.

E Individual Retirement Arrangements (IRAs)

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

IRA Deduction

The following is a summary of the California IRA deductions allowed.

Years	IRA Deduction
1987 – through 1998	California law is the same as federal law. The IRA deduction is the lesser of \$2,000 or 100% of your compensation. If you are covered by an employer's retirement plan or if you file a joint return with your spouse who is covered by such a plan, you may be entitled to only a partial deduction or no deduction at all, depending on your income. See the federal instructions for more information. You can elect to designate otherwise deductible contributions as nondeductible. However, you do not have to elect the same treatment for California purposes that you did for federal purposes. An elective deferral of up to \$6,000 may be made to a SIMPLE IRA.
1982 – through 1986	California law was different from federal law. The maximum federal deduction for an individual was \$2,000, and was available to active participants in qualified or government retirement plans and to persons who contributed to tax-sheltered annuities. The California IRA deduction was the lesser of \$1,500 or 15% of compensation with an additional deduction for a nonworking spouse, for a maximum deduction of \$1,750. An IRA deduction was not allowed if you were an active participant in a qualified or government retirement plan or contributed to a tax-sheltered annuity.
1976 – through 1981	California law was the same as federal law. The IRA deduction for an individual was the lesser of \$1,500 or 15% of compensation. An IRA deduction was not allowed if you were an active participant in a qualified or government retirement plan or contributed to a tax-sheltered annuity.
1975 –	California law was different from federal law. California did not allow an IRA deduction. Therefore, income earned in 1975 and 1976 on the 1975 contribution was taxable. The federal deduction was the same as for years 1976-1981.

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

If you file Form 540NR, your IRA deduction on Schedule CA (540NR), line 23, column E, is limited to the **lesser** of:

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

Example 1

You are a nonresident of California. During the year, you worked temporarily in California. Your California compensation is \$1,000, which you reported on Schedule CA (540NR), column E. Your allowable IRA deduction on your federal return is \$2,000.

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

Distribution

Nonresidents of California After 12/31/95. California does not impose tax on retirement income, including income from an IRA, received by a nonresident after 12/31/95. If you are filing for a prior year and need to determine your California basis, see Example 5 on page 5 for information.

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

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

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

However, if you elected to treat a contribution differently for federal purposes than for California purposes, the taxable amounts will differ. Compute the California taxable amount using the federal instructions. When making the computation, do not treat your nondeductible contributions

made before 1987 as nondeductible contributions. The nondeductible contributions made before 1987 will be recovered as explained in the following paragraph. Compute the adjustment to federal AGI by comparing your federal taxable amount with the California taxable amount. If the federal amount is greater, enter the difference on Schedule CA (540 or 540NR), line 15b, column B, or Form 540A, Side 2, Part I, line 5. If the federal amount is less, enter the difference on Schedule CA (540 or 540NR), line 15b, column C.

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

Your adjustment is the lesser of your:

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

Use Worksheet 1 – Part A on page 8 to compute your pre-1987 California basis. Then use Worksheet I – Part B to compute your adjustment to federal AGI and your remaining pre-1987 California basis. Use Worksheet II as a summary of your California basis and its recovery.

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

(continued on next page)

Example 2 - You were a California resident in 1998 and you received an IRA distribution of \$800. The only other distribution received from your IRA was in 1997. The amount of the 1997 distribution was \$700. You made the following contributions and deductions in prior years:

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

Determination: You would complete Worksheet I as follows.

Worksheet I - Part A Pre-1987 California Basis **Example 2**

(If you have already computed your California basis as of 12/31/97; skip to Part B.)

1 Enter your total federal deductions claimed prior to 1987	1	\$ 5,500
2 Enter your total California deductions claimed prior to 1987	2	4,500
3 Total California basis. Subtract line 2 from line 1	3	\$ 1,000
4 Enter your California basis recovered in prior years	4	700
5 California basis as of 12/31/97. Subtract line 4 from line 3	5	\$ 300

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

1 Enter your taxable distribution from your federal Form 1040, line 15b (or line 16b), Form 1040A, line 10b (or line 11b)	1	\$ 800
2 Enter your California basis as of 12/31/97	2	\$ 300
3 Enter the smaller of line 1 or line 2. Enter this amount on Schedule CA (540 or 540NR), line 15b or line 16b, column B, or Form 540A, Side 2, Part I, line 5 or line 6	3	\$ 300
4 Remaining California basis as of 12/31/98. Subtract line 3 from line 2	4	\$ 0

Included in your federal AGI is the \$800 IRA distribution. Only \$500 (\$800 - \$300) of the distribution is taxable by California in 1998. Your adjustment to federal AGI is \$300. Your California basis has now been fully recovered. When you receive a distribution in later years, the amount of the distribution taxable for federal purposes will also be the amount taxable by California. No adjustment to federal AGI will be necessary.

Example 3 - You were a California resident in 1998 and you received your first IRA distribution. The distribution was \$1,000. For federal purposes, you included \$800 in income and \$200 was treated as the nontaxable recovery of your federal basis. You made the following contributions and deductions in prior years:

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

Determination: You would complete Worksheet I as follows.

Worksheet I - Part A Pre-1987 California Basis **Example 3**

(If you have already computed your California basis as of 12/31/97; skip to Part B.)

1 Enter your total federal deductions claimed prior to 1987	1	\$ 6,000
2 Enter your total California deductions claimed prior to 1987	2	0
3 Total California basis. Subtract line 2 from line 1	3	\$ 6,000
4 Enter your California basis recovered in prior years	4	0
5 California basis as of 12/31/97. Subtract line 4 from line 3	5	\$ 6,000

Worksheet I - Part B Adjustment to Federal AGI and Remaining Pre-1987 California Basis **Example 3**

1 Enter your taxable distribution from your federal Form 1040, line 15b (or line 16b), Form 1040A, line 10b (or line 11b)	1	\$ 800
2 Enter your California basis as of 12/31/97	2	\$6,000
3 Enter the smaller of line 1 or line 2. Enter this amount on Schedule CA (540 or 540NR), line 15b or line 16b, column B, or Form 540A, Side 2, Part I, line 5 or line 6	3	\$ 800
4 Remaining California basis as of 12/31/98. Subtract line 3 from line 2	4	\$5,200

Because your California basis is more than the distribution, none of your IRA distribution will be taxed by California in 1998. Your adjustment to federal AGI is \$800. You have a remaining California IRA basis of \$5,200. You will recover your remaining California basis in later years. Use Worksheet II on page 7, to keep track of your California basis and its recovery. You would complete Worksheet II as follows:

Worksheet II - Summary of California Basis **Example 3**

Taxable Year	Pre-1987 Contributions	Deduction		California Basis in Contribution	Total Distribution	Federal Taxable Amount	California Basis Recovered	Remaining California Basis
		Federal	California					
1984	\$2,000	\$2,000	\$0	\$2,000				\$2,000
1985	2,000	2,000	0	2,000				4,000
1986	2,000	2,000	0	2,000				6,000
1998					\$1,000	\$800	\$800	5,200

Change of Residency

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

If you made IRA contributions when you were a:

- Resident and received IRA distributions before 1/1/96, when you were a nonresident, or
- Nonresident and received IRA distributions at any time when you were a resident,

your California basis is computed differently than previously explained.

Compute your **California basis** by subtracting your federal nondeductible contributions (federal basis) from the total of (1) your California nondeductible contributions; and (2) the earnings on the IRA while you were a nonresident of California.

Do not include in your California basis any rollover contributions made while you were a nonresident.

You recover your California basis before any of the distribution is taxable. The taxable amount of your IRA distribution is the total of your California deductible contributions plus all the earnings on your IRA while you are a California resident.

Example 4 — You became a California resident on 1/1/86. In 1985 while you were a nonresident, the earnings on your IRA were \$200. You received your first distribution from your IRA in 1998. The distribution was \$4,000, all of which was taxable for federal purposes. You made the following IRA contributions and deductions in prior years:

Year	Contributions	Deductions		Earnings While A Nonresident	California IRA Basis
		Federal	California		
1985	\$2,000	\$2,000	\$ 0	\$200	\$2,200
1986	2,000	2,000	1,500		500
1987	2,000	2,000	2,000		
1988	2,000	2,000	2,000		
					\$2,700

Determination: Your California basis is \$2,700 (your \$2,500 nondeductible contributions plus your \$200 in earnings while you were a nonresident of California). Therefore, \$2,700 of the \$4,000 IRA distribution is not taxable by California. Your adjustment to federal AGI is \$2,700. Your California basis has now been fully recovered. When you receive a distribution in later years, the amount of the distribution taxable for federal purposes will also be the amount taxable by California. No adjustment to federal AGI will be necessary.

Example 5 — You became a nonresident of California on 12/31/86. In March 1995, you received a total distribution from your IRA of \$3,150. You had made the following IRA contributions and deductions: (**Note:** If you were a nonresident and received a total distribution after 12/31/95, no part of the distribution would be taxable by California.)

Year	Contributions	Deductions		Earnings While A Nonresident	California IRA Basis
		Federal	California		
1986	\$ 2,000	\$2,000	\$ 1,500	\$ 0	\$ 500
1987 – 1995				1,150	1,150
					\$1,650

Determination: Your California basis is \$1,650 (your \$500 nondeductible contribution plus your \$1,150 in earnings while you were a nonresident of California). Therefore, \$1,650 of the \$3,150 IRA distribution is not taxable by California. Your Schedule CA (540NR), line 15b, column B, adjustment is \$1,650. Your IRA distribution that you must report on Schedule CA (540NR), line 15b, column E is \$1,500 (\$3,150 - \$1,650).

Example 6 — You became a California resident on 1/1/86. In 1985, while you were still a nonresident of California, you received a \$50,000 lump-sum distribution from your employer's retirement plan and rolled over the distribution to an IRA. The earnings on your IRA in 1985 were \$2,000. You received your first distribution from your IRA in 1998. The distribution was \$4,000, all of which was taxable for federal purposes. Your California basis is determined as follows:

Year	Rollover Contributions	Earnings While A Nonresident	California IRA Basis
1985	\$50,000	\$2,000	\$ 2,000

Determination: Your California basis is \$2,000, the amount of earnings in the IRA while you were a nonresident. Therefore, \$2,000 of the \$4,000 IRA distribution is not taxable by California. Your Schedule CA (540), line 15b, column B, adjustment is \$2,000. Your California basis has now been fully recovered. When you receive a distribution in later years, the amount of the distribution taxable for federal purposes will also be the amount taxable by California. No adjustment to federal AGI will be necessary.

Simplified Employee Pension (SEP)

Deduction

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

Form 540NR filers after 12/31/95. Compute the Schedule CA (540NR) column E amount by multiplying the federal SEP deduction by a ratio of

California source income to total self-employment income.

Self-employment income from Schedule CA (540NR), column E \times Schedule CA (540NR), line 29, column D

Self-employment income from Schedule CA (540NR), column D

Prior to 1/1/96 there may have been a difference in the amount of the SEP deduction you claimed

if there was a difference between your federal self-employment income and your California self-employment income (residents, part-year residents or nonresidents of California).

Form 540NR filers prior to 1/1/96. Your SEP deduction on Schedule CA (540NR), column E is based upon the percentage of self-employment income from Schedule CA (540NR), column E to total self-employment income computed according to California law on Schedule CA (540NR), column D.

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

Self-employment income from Schedule CA (540NR), column E \times Schedule CA (540NR), line 29, column D
 Self-employment income from Schedule CA (540NR), column D

Distribution

Nonresidents of California after 12/31/95:

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

Residents of California:

The distribution of a SEP is treated the same as the distribution of an IRA. Your distribution is first considered a nontaxable return of your California basis. Once your California basis is recovered, your distribution will be reported the same as federal.

Use Worksheet I – Part A on page 8 to compute your pre-1987 California basis. Then use Worksheet I – Part B to compute your adjustment to federal AGI and your remaining pre-1987 California basis. Use Worksheet II as a summary of your California basis and its recovery.

California Basis. Your California basis is the amount of your SEP contributions that were not allowed as a deduction on your California return and any contributions and earnings attributable to periods of nonresidency.

F Self-Employed Retirement Plans (KEOGHS)

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

Deduction

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

Form 540NR filers after 12/31/95. Compute the Schedule CA (540NR), column E amount by multiplying the federal Keogh deduction by a ratio of California source self-employment income to total self-employment income.

Self-employment income from Schedule CA (540NR), column E \times Schedule CA (540NR), line 29, column D
 Self-employment income from Schedule CA (540NR), column D

Example 7 — You are a part-year resident of California. Your total self-employment income for the year is \$300,000, and the amount to be reported on Schedule CA (540NR), line 12, column E, is \$100,000. Your Keogh deduction for federal purposes is \$15,000. Your Keogh deduction to be reported on Schedule CA (540NR), line 29, column E is computed as follows:

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

Report \$5,000 on Schedule CA (540NR), line 29, column E.

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

Form 540NR filers prior to 1/1/96. Your Keogh deduction on Schedule CA (540NR), column E is based upon the percentage of self-employment income from Schedule CA (540NR), column E to total self-employment income computed according to California law on Schedule CA (540NR), column D.

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

Self-employment income from Schedule CA (540NR), column E \times Schedule CA (540NR), line 29, column D
 Self-employment income from Schedule CA (540NR), column D

Distribution

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

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

California Basis. Your California basis is the amount of contributions you made for which you were not allowed a deduction on your California return. You may not have been allowed a deduction of the full amount of your contributions because the maximum California Keogh deduction was less than the federal deduction prior to 1987.

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

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

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

Use Worksheet I – Part A on page 8 to compute your pre-1987 California basis. Then use Worksheet I – Part B to compute your adjustment to federal AGI and your remaining pre-1987 California basis. Use Worksheet II as a summary of your California basis and its recovery.

Example 8 – In 1998, you received a Keogh distribution of \$15,000. In 1997, you also received a Keogh distribution of \$15,000. Your Keogh contributions were made in 1979 through 1983. The total contributions were \$37,500. Your total California deductions were \$12,500.

Determination: You would complete Worksheet I as follows.

Worksheet I – Part A Pre-1987 California Basis

Example 8

(If you have already computed your California basis as of 12/31/97; skip to Part B.)

1	Enter your total federal deductions claimed prior to 1987	1	\$ 37,500
2	Enter your total California deductions claimed prior to 1987	2	12,500
3	Total California basis. Subtract line 2 from line 1	3	\$ 25,000
4	Enter your California basis recovered in prior years	4	15,000
5	California basis as of 12/31/97. Subtract line 4 from line 3	5	\$ 10,000

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

Example 8

1	Enter your taxable distribution from your Federal Form 1040, line 15b (or line 16b), Form 1040A, line 10b (or line 11b)	1	\$ 15,000
2	Enter your California basis as of 12/31/97	2	\$ 10,000
3	Enter the smaller of line 1 or line 2. Enter this amount on Schedule CA, (540 or 540NR), line 15b or line 16b, column B or Form 540A, Side 2, Part I, line 5 or line 6	3	\$ 10,000
4	Remaining California basis as of 12/31/98. Subtract line 3 from line 2	4	\$ 0

Only \$5,000 (\$15,000 – \$10,000) of the distribution is taxable by California in 1998. Your adjustment to federal AGI is \$10,000. Your California basis has now been fully recovered. When you receive a distribution in later years, the amount of the distribution taxable for federal purposes will also be the amount taxable by California. No adjustment to federal AGI will be necessary.

Exception: If you made voluntary contributions that were not deductible on your federal and California returns, do not include the amount of the voluntary contributions in your California basis. The recovery of the voluntary contributions for California is treated the same as the recovery for federal purposes. **Do not** make an adjustment on Schedule CA (540 or 540NR) or Form 540A, Side 2, Part I, line 5 or line 6 to recover your voluntary contributions.

Lump-sum Distribution

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

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

California taxable amount	=	federal Form 1099-R, box 2a	–	Worksheet I Part B, line 3
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Enter the California taxable distribution on Schedule G-1, line 10 unless the capital gain election was made. If the capital gain election was made:

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

Sch. G-1, line 10	=	California taxable amount	–	Sch. G-1, line 8
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Change in Residency

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

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

G Tax On Early Distributions

California has a tax on early distributions from IRAs, any qualified retirement plans, annuities and modified endowment contracts. This tax is generally the same as federal except the California tax rate is 2½% rather than 10%, except for early distributions from SIMPLE plans during the two-year period beginning on the date the taxpayer first began participation in the plan. In that case, the tax rate is 6% rather than 25%. California does not have taxes similar to the federal tax on excess accumulations, tax on excess contributions or tax on excess distributions.

Early Distributions. Early distributions are amounts you withdraw from your qualified retirement plan, annuity or modified endowment contract before you are age 59½. The tax on early distributions is 2½% of the amount of the distribution included in income or 6% in the case

of an early distribution from a SIMPLE plan during the first two-year period beginning on the date the taxpayer first began participation in the plan. The tax on early distribution is imposed in addition to any regular California income tax on the distribution. You must figure this tax on form FTB 3805P, Additional Taxes Attributable to IRAs, Other Qualified Retirement Plans, Annuities, Modified Endowment Contracts and MSAs.

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

- The portion of the distribution that is a return of basis;
- Distributions made because you became disabled;
- Distributions made as a part of a series of substantially equal payments made for the life (or joint lives) of you and your designated beneficiaries;
- Distributions made after the death of the participant;
- Distributions made to you to the extent you have medical expenses deductible under IRC Section 213 (whether or not you itemize your deductions);
- Distributions made to unemployed individuals for health insurance premiums under IRC Section 72(t)(2)(D);
- Distributions made for qualified higher education expenses;
- Distributions of up to \$10,000 made for first home purchases;
- Distributions made to you after you separated from service with your employer in or after the year in which you reached age 55; or
- Distributions paid under a qualified domestic relations order.

Note: The last two exceptions do not apply to distributions from IRAs or annuity or modified endowment contracts. They apply only to distributions from qualified employee plans.

Prohibited Transactions. You may also owe tax on early distributions from an IRA or SEP if you enter into a prohibited transaction. If you enter into a prohibited transaction, your IRA ceases to be an IRA on the first day of the taxable year and you are considered to have received a distribution of the entire value of your IRA. If you are under age 59½ on the first day of the taxable year, you are subject to the tax on early distributions. Get form FTB 3805P for more information.

H California Credits

Other State Tax Credit

If you paid tax to California and to another state on the same pension income prior to 1996, you may qualify for a credit for taxes paid to another state. For more information get Schedule S, Other State Tax Credit.

Exemption Credit for Seniors Age 65 or Older

California allows an additional exemption credit for individuals age 65 or older rather than the larger standard deduction allowed on the federal return. Be sure to claim this credit on your California income tax return.

I Additional Information

Where To Get Income Tax Forms

By Internet – If you have Internet access you may download, view and print California income tax forms and publications. Our Internet address is:

<http://www.ftb.ca.gov>

By phone – Use F.A.S.T. to order 1998 tax forms. Call (800) 338-0505 and follow the recorded instructions. F.A.S.T. is available from 6 a.m. to 12 midnight Monday through Friday, except state holidays and 6 a.m. until 10 p.m. Saturday and Sunday. Please allow 2 weeks to receive your order. If you live outside of California, please allow 3 weeks to receive your order.

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

By mail – Write to: TAX FORMS REQUEST UNIT, FRANCHISE TAX BOARD, PO BOX 307, RANCHO CORDOVA CA 95741-0307.

Letters. We can serve you by phone if you call us for information to complete your California income tax return or to find out about your tax refund. However, you may want to write us if you are replying to a notice we sent you or to get a written reply. If you write to us, be sure to include your social security number, your daytime and evening telephone numbers and a copy of the notice with your letter. Send your letter to:

FRANCHISE TAX BOARD
PO BOX 942840
SACRAMENTO CA 94240-0040

We will acknowledge receipt of your letter within six to eight weeks. In some cases, we may need to call you for additional information.

General Toll-Free Phone Service

Between January 4 – April 15, 1999, our general toll-free phone service is available:

- Monday – Friday, 6 a.m. until midnight; and
- Saturdays, 8 a.m. until 5 p.m.

After April 15, 1999, our general toll-free phone service is available:

- Monday – Friday, 7 a.m. until 8 p.m.

The best times to call are before 10 a.m. and after 6 p.m.

From within the United States	(800) 852-5711
From outside the United States	(916) 845-6500 (not toll-free)

For hearing impaired with TDD	(800) 822-6268
For federal tax questions, call the IRS at	(800) 829-1040

Asistencia Bilingüe en Español

Para obtener servicios en Español y asistencia para completar su declaración de impuestos/formularios, llame al número de teléfono (anotado arriba) que le corresponde.

