A tour of the primary forms used in a California individual income tax return.

Introduction

Before you read any further, I encourage you to download copies of Form 540 and Schedule (CA) 540, along with the instructions. Refer to these as you read.

The biggest single difference between Federal and California tax forms is their starting point: Federal forms take most of their information from the taxpayer's records ("list your dividends here", "list your total charitable contributions here"). The starting point for most California tax forms is the Federal tax return. The California form then shows the Federal/California differences (if any), and then the same tax information but according to California law.

Although most tax items per Federal law are treated the same under California law, there are some differences. Note that there are some Federal/California tax differences which are fairly unusual – those are beyond the scope of this class.

What follows is a section-by-section walk through of the two most frequently used forms in a California individual tax return. Schedule CA (540) is a reconciliation schedule that traces each type of income and deduction from a Federal 1040 and then shows the adjustment amounts to get to those amounts per California tax law. What the schedule does not show is how or when to adjust – this comes from the instructions and researching the California law. Form 540 is California's equivalent to the Federal 1040 but it does not look like a Form 1040: the California Form 540 only summarizes the taxpayer's income and deductions, dependents, taxable income, tax liability, tax payments, and net refund or additional tax due.

When doing a California return, much of the detail we expect to see on a Federal 1040 is actually presented on a Schedule CA (540), not the Form 540 itself. The Schedule CA (540) feeds information into the Form 540.

Because Schedule CA (540) feeds into Form 540, we discuss CA (540) first. The 2014 tax year of these forms are used.

(continued next page)

Schedule CA (540)

Part I – Income Adjustment Schedule

Section A – Income

Column A – Federal Amounts

Look at the snapshot of CA (540) Part I Section A- Income:

TAXABLE YEAR 2014 **California Adjustments — Residents** SCHEDULE **CA (540)**

Important: Attach this schedule behind Form 540, Side 5 as a supporting California schedule.

Name(s) as shown on tax return | SSN or ITIN

Part I Income Adjustment Schedule **Section A – Income**	A Federal Amounts (taxable amounts from your federal tax return)	B Subtractions See instructions	C Additions See instructions
7 Wages, salaries, tips, etc. See instructions before making an entry in column B or C 7			
8 Taxable interest (b)_____ . . . . . 8(a)			
9 Ordinary dividends. See instructions. (b) _____ . . . . . 9(a)			
10 Taxable refunds, credits, offsets of state and local income taxes 10			
11 Alimony received 11			
12 Business income or (loss) 12			
13 Capital gain or (loss). See instructions 13			
14 Other gains or (losses) 14			
15 IRA distributions. See instructions. (a)_____ . . . . . 15(b)			
16 Pensions and annuities. See instructions. (a)_____ . . . . . 16(b)			
17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. 17			
18 Farm income or (loss) 18			
19 Unemployment compensation 19			
20 Social security benefits (a) _____ . . . . . 20(b)			
21 Other income. a California lottery winnings; b Disaster loss carryover from FTB 3805V; c Federal NOL (Form 1040, line 21); d NOL carryover from FTB 3805V; e NOL from FTB 3805D, 3805Z, 3806, 3807, or 3809; f Other (describe): _____ 21		a b c d e f	a b c d e f
22 **Total.** Combine line 7 through line 21 in column A. Add line 7 through line 21f in column B and column C. Go to Section B. 22			

Take a minute to browse the row-by-row descriptions for this section – the first thing that you should notice is that each row is in the same order as page 1 of Federal Form 1040. Every separate type of income or adjustment for AGI which is shown on a 1040 is reported here. Using the amounts as they are reported on federal Form 1040 is **not** a suggested starting point, it is **required.** This provides an audit trail for the California Franchise Tax Board to trace numbers from a taxpayer's records to the Federal return and then to the California return. It also makes it easier for you to prepare.

Reading the California forms, instructions, and law, you will notice that California tax law frequently mentions Federal law "by reference." This means California law essentially says "California follows Internal Revenue Code Section 1234 as of January 1, 20XX." Because California laws often start with Federal tax law, having California tax returns also start with Federal amounts makes perfect sense.

CA (540) Section B – Adjustments to Income

Section B mirrors Lines 23 to 37 of Form 1040 – these are "Deductions FOR Adjusted Gross Income ('AGI')". Column A reports Federal law AGI adjustments but Columns B and C report any "adjustments to the adjustments." Notice in some rows, Columns B or C (or both) are blacked out, indicating that no adjustment is ever allowed. Line 37 totals are transferred to Form 540, Page 1.

In other words, preparing Column A of Page 1 of Schedule CA (540) is pretty simple – you take the appropriate numbers directly from Federal Form 1040. There should be no exceptions to this (that the instructors are aware of, anyway).

Look at the snapshot of CA (540) Section B below:

Section B – Adjustments to Income				
23	Educator expenses	23		
24	Certain business expenses of reservists, performing artists, and fee-basis government officials	24		
25	Health savings account deduction	25		
26	Moving expenses	26		
27	Deductible part of self-employment tax	27		
28	Self-employed SEP, SIMPLE, and qualified plans	28		
29	Self-employed health insurance deduction	29		
30	Penalty on early withdrawal of savings	30		
31a	Alimony paid. (b) Recipient's: SSN ___ ___ ___ – ___ ___ – ___ ___ ___ ___ Last name _____	31a		
32	IRA deduction	32		
33	Student loan interest deduction	33		
34	Tuition and fees	34		
35	Domestic production activities deduction	35		
36	Add line 23 through line 31a and line 32 through line 35 in columns A, B, and C. See instructions	36		
37	**Total.** Subtract line 36 from line 22 in columns A, B, and C. See instructions	37		

CA (540) Sections A and B -- Columns A, B and C

Each row of Section A and Section B is divided into three columns:

- Column A is Federal amounts – these should be the same as what is reported on Form 1040.
- Column B is any subtractions to get from Federal income to California income.
- Column C is any additions to get from Federal to California income.

Notice that the amounts "added to" and "subtracted from" go into separate columns; <u>you do not "net" your amounts in one column.</u>

Example (for Line 8(a)): Lee receives $5,000 in U.S. Treasury Bill interest income – which is taxable for Federal law but tax-exempt for California. Lee also receives $3,000 in City of Miami Florida Municipal bond interest – which is tax-exempt for Federal

purposes but taxable for California purposes. Lee should put $5,000 in column B and $3,000 in column – Lee should NOT show a net $2,000 in column B.

Notice that there is no "Column D" on this form that shows the resulting California income by line. Instead, you calculate totals by column and carry those totals to Form 540.

Federal/California adjustments were previously discussed but they are worth reviewing here. Common adjustments include:

- U.S. Treasury bond interest – taxable for Federal but exempt for California
- Non-California state, county, or municipal bond interest – tax-exempt for Federal but taxable for California. California only exempts bonds from political subdivisions (i.e. cities, counties) inside California or from the State of California. Note: some states exempt bonds from anywhere but others exempt only bonds from within their state. If you prepare other state returns, you must check on a state-by-state basis.
- State tax refunds included on a Federal 1040 – a refund is never taxable in California because the state income tax was never deducted on a California return in the first place.
- Social security payments – completely tax exempt in California.
- Unemployment compensation – completely tax exempt in California.
- My personal favorite – "California Lottery" (the official state run lottery) prizes are tax exempt in California. I think this includes the multi-state gigantic jackpot if California participates. Other types of gambling income (including winnings from a casino inside the state [i.e. an Indian tribal casino] is taxable for California.
- **A common adjustment for a self employed small business owner** is depreciation expense for fixed assets (equipment, furniture, computers, etc). Some types of business assets are depreciated under slightly longer lives for California and the Section 179 expense limit is smaller for California than it is for Federal. The 2014 limit for Section 179 is $500,000 for federal purposes but only $25,000 for California purposes.

  If you have an asset that you can fully expense for Federal purposes but not California, then the remaining basis is depreciated for California purposes as a mini-asset. These differences create different depreciation expense amounts for federal and California, which results in an adjustment on Schedule CA (540) and a different net business profit on the California return.

  This difference is reported as an addition or subtraction to Line 12 (Business Income) on Schedule CA (540).

Here is an example:

John Smith is a self-employed machinist with his own shop with $600,000 of net income in 2014 before buying the following new asset. In 2014, he purchases a new milling machine that costs $75,000****. Under Federal law, he can expense up to $500,000 of purchased fixed assets as a Section 179 depreciation expense (limited to his business income). Therefore, he can expense the entire $75,000 cost of the machine for Federal purposes. California has a similar Section 179 depreciation expense option but only $25,000 per year is allowed (the CA limit has not kept up with the Federal amount because of CA budget problems).

So, the first two years of this depreciation expense will be as follows:

Year	Federal expense	California expense*	Increase (Decrease) to CA income
2014	$75,000	$35,000**	$40,000
2015	$0	$16,000***	($16,000)

Notice that in this example, (assuming Smith does not purchase any other depreciable assets in 2014 and 2015), his California income will be higher than federal income in 2014 but then be lower in future years as the California depreciation expense becomes larger than the Federal expense. The reason is the depreciation expense allowed.

For federal purposes, the depreciation is reported on federal Form 4562, then onto Schedule C, then onto Form 1040. For California purposes, the depreciation adjustment is reported on CA Form 3885A, then the difference goes onto Schedule CA (540), Line 12 - either Column B or Column C (depending on the whether the adjustment increases or decreases the business income).

*Assumes 5-yr double-declining balance MACRS (see Ch. 7 & Pub 946)
**$25,000 California Sec. 179 exp. + $10,000 ($50,000 asset basis x 20%) = $35,000.
***$50,000 asset basis x 32% = $16,000.
****I don't know what a milling machine really costs – it's just an example.

There are other federal/California adjustments to income but most of them are pretty unusual – it is not practical to discuss them in an introductory level tax class.

The schedule's instructions provide a useful overview of common adjustments and how to report them.

(continued next page)

CA (540) Part II – Adjustments to Federal Itemized Deductions

Part II Adjustments to Federal Itemized Deductions

38 Federal itemized deductions. Enter the amount from federal Schedule A (Form 1040), lines 4, 9, 15, 19, 20, 27, and 28 38

39 Enter total of federal Schedule A (Form 1040), line 5 (State Disability Insurance, and state and local income tax, or General Sales Tax) and line 8 (foreign income taxes **only**). See instructions 39

40 Subtract line 39 from line 38 40

41 Other adjustments including California lottery losses. See instructions. Specify 41

42 Combine line 40 and line 41 42

43 **Is your federal AGI (Form 540, line 13) more than the amount shown below for your filing status?**
Single or married/RDP filing separately **$176,413**
Head of household **$264,623**
Married/RDP filing jointly or qualifying widow(er) **$352,830**
No. Transfer the amount on line 42 to line 43.
Yes. Complete the Itemized Deductions Worksheet in the instructions for Schedule CA (540), line 43 43

44 **Enter the larger of the amount on line 43 or your standard deduction listed below**
Single or married/RDP filing separately. See instructions. **$3,992**
Married/RDP filing jointly, head of household, or qualifying widow(er) **$7,984**
Transfer the amount on line 44 to Form 540, line 18 44

Part II is for converting your itemized deductions from federal amounts to California amounts. Part II is formatted differently from Part I and it is actually simpler. The good news about most common itemized deductions is that with one big exception (state and foreign taxes), total federal itemized deductions before any high income limits are usually the same for California.

On Line 38, add together each of the "category" sub-totals from federal Schedule A (i.e. total deductible medical costs, total interest, total taxes, etc.). **Notice that you do NOT simply use the Federal Schedule A Line 29 grand total from the bottom of the Federal Schedule A (this is a common error by students).**

The reason that you add together all of the Federal itemized deduction sub-totals before the Federal limitation of itemized deductions is because California calculates the itemized deduction limitation differently. In fact, the federal itemized deduction limitation returned in 2013 after several years of not being part of the law but the California limitation has always been in force.

In years when federal has an itemized deduction limitation, the federal calculation uses different dollar amounts and sometimes a different calculation method than for the California itemized deduction limitation. Don't blame California for this confusion--- the California calculation has stayed the same for over twenty years while Congress keeps changing the federal calculation for political reasons.

Line 39 and 40 calculate the biggest single difference between federal and California itemized deductions. On Line 39, list any state income taxes (or state sales taxes) deducted on the federal return, along with any California State Disability Insurance taxes

(some California employees have this on their paychecks – it is deductible for federal purposes) and any foreign taxes which are deducted (rather than claimed as a "foreign tax credit").

Notice that real estate property taxes and personal property taxes (i.e. the deductible part of CA DMV car registrations) which are deducted for Federal purposes are also deducted for California purposes.

Line 40 is simply your total itemized deductions, less the Line 39 non-deductible taxes.

On Line 41, list any other adjustments to itemized deductions that are necessary. Items here are unusual but not unheard of. One of the instructors actually used this space on his return several years ago: there is a federal credit which allows pre-approved first-time homebuyers to claim up to 15% of their mortgage interest as a tax credit, instead of as an itemized deduction. In turn, only 85% of the mortgage interest is deducted on the Federal Schedule A (otherwise, that 15% of the mortgage interest benefits the taxpayer twice). On the instructor's California return, that "missing" 15% of mortgage interest was included on Line 41 as additional mortgage interest for California purposes because California does not give a similar tax credit. This is an example of the kinds of odd adjustments that tax preparers should be watchful for.

Lines 43 and 44 are fairly mechanical – taxpayers with a **federal** AGI exceeding a certain amount have their total itemized deductions reduced. **It is important to remember that the California itemized deduction limitation for high AGI taxpayers might be calculated differently than the limitation on federal tax returns. Always do the California calculation separately – do not just use the federal calculation.**

We will have a brief re-visit of the itemized deduction limitation briefly here. It is actually a pretty "mechanical" calculation and there is a worksheet on page 7 of the Schedule CA (540) instructions that is useful:

Itemized Deductions Worksheet

1. Amount from Schedule CA (540), line 42 . . . . . 1 _____
2. Using California amounts, add the amounts on federal Schedule A (Form 1040), line 4, line 14, and line 20 plus any gambling losses included on line 28 . . . . . 2 _____
3. Subtract line 2 from line 1 . . . . . 3 _____
   If zero, 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 _____
   Note: If zero 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 _____

1. Start with your "gross" California itemized deductions (i.e. after you have removed the taxes that are only deductible for Federal tax purposes).

2. Check your California filing status and determine if your Federal AGI is above the stated amount (example: for MFJ, it is $352,830 in 2014)

3. Note that these amounts vary by filing status and are adjusted each year for inflation. If the answer is "no", then your deductions are not limited.

4. Using the California calculated amount, you determine the total for any itemized deductions that are "exempt" from the high-AGI limitation. This list includes medical costs, investment interest expense, casualty losses, and deductible gambling expenses. Subtract this amount from your "gross" California itemized deductions and you now have the total California itemized deductions which may be reduced due to having a high AGI. If all of your itemized deductions are "exempt", then you have no limitation (note that I have never actually seen this happen but it's possible).

5. Multiply the amount you determined in step 3 by 80%. This is the largest amount by which your California itemized deductions can be reduced. In other words, even if you are Larry Ellison and make hundreds of millions each year, you still get to claim at least 20% of your itemized deductions.

6. Subtract the stated amount you determined in Step 2 from your Federal AGI and determine the excess amount. For example, if you file MFJ and your Federal AGI is $500,000, your "excess amount" is $147,170 ($500,000 minus $352,830).

7. Multiply the "excess amount" from Step 5 by 6%. This amount is your potential reduction amount. Continuing the example from Step 5, the reduction amount is $8,830 ($147,170 x 6%).

8. Compare the potential reduction amount from Step 6 with the 80% worst case reduction amount from Step 4. Use the smaller amount and subtract it from your California itemized deductions which are subject to limitation. That net amount is what is reported on Line 43 of Schedule CA (540).

Example: Fred and Wilma file MFJ and have a Federal AGI of $500,000 and "gross" California itemized deductions of $80,000 (that is, Federal itemized deductions less any taxes which are not deductible for California). They have a $10,000 net medical expense deduction from Line 4 of the Federal Schedule A but all of their other itemized deductions are subject to the limitation. Therefore, their gross California itemized deductions which may be limited is $70,000. 80% of $70,000 is $56,000 (the "worst case

scenario"). Their potential reduction amount is $8,830 (see steps 5 & 6 above for how this was calculated). The smaller of $8,830 or $56,000 is used to reduce their California itemized deductions. Thus, their "net" California itemized deductions is $71,170 ($80,000 minus $8,830) which goes on Line 43 of Schedule CA (540).

If the taxpayer's "net" California itemized deductions are smaller than the California standard deduction, they may claim a standard deduction for California purposes. Notice that the California standard deductions amounts are different from the Federal amounts.

Is it legal for a taxpayer to itemize deductions on the Federal return and claim a standard deduction on the California return <u>or the other way around?</u> YES -- the form instructions discuss how to address this unusual situation. The net deduction amount is then transferred to Form 540, Page 1, Line 18.

Many students have complained about how confusing this Schedule can be. An example of a prepared Schedule CA (540) ("John & Mary Smith) is posted in the module for you to see.

<u>Form 540</u>

As discussed before, Form 540 is very different from Federal Form 1040 in that it does not list taxable income by category – Schedule CA (540) does that. Instead, the form <u>starts</u> with Federal AGI and summarizes the various adjustments determined on Schedule CA (540).

We will walk through Form 540 section-by-section, highlighting differences with the Federal Form 1040.

<u>Filing Status</u>

Generally speaking, California filing status conforms to Federal rules for filing status. Prior to the 2013 Supreme Court decision striking down the Defense of Marriage Act, a same-sex couple could not file a married-filing-jointly tax return for federal purposes but could do so for California purposes. From 2013 onward, a same-sex couple will be able file MFJ for federal and California purposes. Note that this issue varies on a state-by-state basis; if you prepare a state return for another state, different rules may apply.
If you become a tax preparer and encounter this situation with one of your clients, be sure to check for the most up to date information on this area.

<u>Exemptions – a California tax credit (not a tax deduction)</u>

Generally speaking, California conforms to the Federal rules for qualifying to claim personal and dependent exemptions. The big Federal/California difference is in how the actual calculations are performed so that exemptions reduce your final tax liability.

There are two notable differences in how these benefits impact the final tax liability:

- Instead of a deduction from taxable income (like Federal), in 2014 the exemption is given as a $108 tax credit per taxpayer and as a $333 per dependent. The final impact is essentially the same (a reduction in the gross tax liability) but for some reason, California uses a credit. In other words, the exemption "benefit" is in a different place in the tax calculation formula.

- In 2014 taxpayers over 65 and/or blind receive an extra $108 tax credit, instead of a larger standard deduction. On the Federal return, the blind and/or over 65 receive a benefit only if they claim a standard deduction. In California, a taxpayer can itemize deductions and still get these extra tax benefits.

Exemptions

▶ For line 7, line 8, line 9, and line 10: Multiply the amount you enter in the box by the pre-printed dollar amount for that line. **Whole dollars only**

7 **Personal:** If you checked box 1, 3, or 4 above, enter 1 in the box. If you checked box 2 or 5, enter 2, in the box. If you checked the box on line 6, see instructions.. 7 X $108 = $

8 **Blind:** If you (or your spouse/RDP) are visually impaired, enter 1; if both are visually impaired, enter 2 . . . . . 8 X $108 = $

9 **Senior:** If you (or your spouse/RDP) are 65 or older, enter 1; if both are 65 or older, enter 2 . . . . . 9 X $108 = $

10 **Dependents: Do not include yourself or your spouse/RDP.**

First name	Last name	Dependent's relationship to you

Total dependent exemptions. . . . . 10 X $333 = $

11 **Exemption amount:** Add line 7 through line 10. Transfer this amount to line 32 . . . . . 11 $

Just like the itemized deductions, these exemption credits are subject to a phase-out for high AGI taxpayers. The cut-off amount depends on your filing status and it adjusts every year. For 2014, the cut-off begins at $176,413 for single/married (or RDP) filing separate, $352,830 for married (or RDP) filing jointly, and $264,623 for Head of Household (I believe these cut-off amounts are the same as those used for itemized deductions).

There is a calculation worksheet on Page 9 of the Form 540 instructions – it essentially reduces the amount of the exemption credits as the taxpayer's AGI increases. It is a good idea to try doing a quick self-study of this calculation with sample numbers.

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AGI Limitation Worksheet
Use whole dollars only.

a	Enter the amount from line 13		a_____
b	Enter the amount for your filing status on line b:		
	• Single or married/RDP filing separately	$176,413	b_____
	• Married/RDP filing jointly or qualifying widow(er)	$352,830	
	• Head of household	$264,623	
c	Subtract line b from line a		c_____
d	Divide line c by $2,500 ($1,250 if married/RDP filing separately). If the result is not a whole number, round it to the next higher whole number		d_____
e	Multiply line d by $6		e_____
f	Add the numbers from the boxes on lines 7, 8, and 9 (not the dollar amounts)		f_____
g	Multiply line e by line f		g_____
h	Add the total **dollar amount** from lines 7, 8, and 9		h_____
i	Subtract line g from line h. If zero or less, enter -0-		i_____
j	Enter the number from the box on line 10 (not the dollar amount)		j_____
k	Multiply line e by line j		k_____
l	Enter the **dollar amount** from line 10		l_____
m	Subtract line k from line l. If zero or less, enter -0-		m_____
n	Add line i and line m. Enter the result here and on line 32		n_____

Page 2
Taxable Income

Lines 12 – 19 are really pretty straightforward because the taxpayer is simply transferring summary data which is reported on their Form W-2, Federal 1040, and California Schedule 540 (CA).

Note – the Form 540 and instructions available from the FTB website completely omits Lines 20 to Line 30, Line 36 to 39, Lines 41 to 42, Lines 49 to 60, Lines 65 to 70, Lines 76 to 90, and Lines 96 to 109. In other words, the form just skips from Line 19 to Line 31, and so on. A similar format was used last year. There is no explanation for why these line numbers are missing. The good news is that it is only the line numbering that seems strange – the "flow" of the form itself is still presented in a logical fashion.

Tax

Line 31 is where most California taxpayers will report their income tax. If taxable income is under $100,000, use the tax table – not the tax rate formulas. FTB Form 3800 and 3803 are applicable for taxpayers who include their child's taxable income on their return under California equivalent of the "Kiddie Tax." Consult the form instructions for more details should this situation arise.

The exemption credits are deducted from the taxpayer's gross tax liability on Line 32.

Line 34 - Schedule G-1 and Form 5870A taxes are from lump-sum retirement distributions and distributions from foreign trusts (consult the instructions). Any discussion of those issues is beyond the scope of an introductory income tax class.

Special Credits

Lines 40 to 48 is where you deduct other California tax credits. While some are similar to credits at the Federal level (adoption costs or dependent care expenses, for example), there are numerous California only credits. You can view the list of credits on the FTB website – there are too many to discuss in any detail and many of them target very specific groups (dependent parents, renter's credits, and so on).

Page 3
Other Taxes

Like Federal, California has an Alternative Minimum Tax. The good news is that it is computed in almost the same manner as the Federal AMT (please consult Federal Chapter 6 in your textbook and modules for a discussion of AMT). The California AMT is computed on Schedule P (540) and any AMT is reported on Line 61.

We will not do a line-by-line discussion of Schedule P (540) because the California AMT concept is almost the same as the federal AMT concept.

There is **one big difference** between the Federal AMT and California AMT:

> The "AMTI Exclusion" (Line 17 on Schedule P (540)): California has a special AMT benefit for small-business owners' which does NOT exist in the Federal AMT world. Those with $1 million or less gross receipts from their small business can exclude their self-employment earnings from the CA AMT calculation. In other words, having a small business in California will almost certainly NOT cause you to pay CA AMT. California has a reputation as an unfriendly place for business, so this is a really nice benefit to small business owners.

Line 62: Mental Health Services tax: California levies an extra 1% tax on any taxable incomes greater than $1 million (the first $1 million is not subject to this tax).

On Line 63 you report any other miscellaneous taxes, such as extra taxes on non-qualified retirement plan distributions, or recaptures of tax credits.

Lines 71 to 73 are for tax withholdings (from a paycheck, certain real estate transactions) and quarterly tax estimate payments.

Line 74 is for excess SDI/VPDI payments. Basically, a taxpayer should pay SDI tax on only the first part of their salary each year and after that amount is earned, the employer stops collecting the tax. What if you change jobs during the year? Your new employer basically "starts over" as if you haven't earned anything during the year – you wind up paying SDI tax twice. These excess payments can be claimed as payments toward your income taxes or refunded. The Federal 1040 has a similar line for excess social security

taxes. For 2014, excess SDI payments apply to your CA income tax only if you have paid more than $1,016.36 in SDI taxes. If this happens, only the amount **in excess of $1,016.36** can be applied to your income taxes. Consult the instructions for how to calculate this credit.

Page 4
Use Tax and Contributions

Form 540 has a line for "Use Tax" (line 95). Under California law (and in most other states), if you make a purchase where the seller is "out of state," no sales tax is collected. In this case, the purchaser is required to pay "use tax" (which is simply a sales tax when "sales tax" isn't collected). Example: Many internet retailers arrange their operations to be outside major states (like California) for various tax reasons, including not being required to collect sales tax. Simply put, you are supposed to voluntarily pay use tax when sales tax isn't collected and this line is where you pay it. Admittedly, this is difficult to enforce for now but there have been multi-state projects to simplify sales tax law that may change this someday (Large online retailers like Amazon.com are starting to collect sales tax in California now).

On page 4 are "contributions." Contributions are what they sound like – certain charitable causes have been favored by the state government with a place on the tax form where you can donate. Participation is voluntary but you cannot change your mind once the return is filed – meaning you cannot amend your tax return and take back the contribution.

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The remainder of Form 540 is essentially the same as Form 1040 with sections for amounts owed or refunds due, interest and penalties, direct deposits, and a signature under penalty of perjury.

Conclusion

In addition to Form 540 and Schedule CA (540), the Franchise Tax Board has many other tax forms that may be required. For example, Schedule P (540) is for California Alternative Minimum Tax and is almost identical to federal Form 6251. While we don't have the time to cover other California forms, keep in mind that they are either closely modeled after their Federal equivalent or (like the Schedule CA (540)) they use the federal tax amounts as a starting point. A good understanding of federal tax forms makes it fairly easy to understand California (or other state) forms.