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## UPDATE ON FEDERAL-CALIFORNIA TAX DIFFERENCES

By Victor Sy, CPA, MBA

Today's article will focus on differences between California and Federal tax laws. While California conformed to most California changes, some provisions took effect later than Federal versions while some provisions were never conformed to. Thus, many new differences between Federal and California law now exist and are discussed as follows:

1. Federal law requires that **State income tax refunds** be included in gross income in the year received. California does **not** tax State tax refunds since the State does not allow any deductions for State and local income taxes.
2. **Unemployment compensation** is taxable under federal laws but continues to be tax-free for California taxation. Thank you.
3. Federal law taxes one-half of **Social Security benefits** in excess of threshold amounts. California does **not** tax any Social Security benefits received.
4. Federal law taxes all **lottery winnings** while California law excludes gross income from California state lottery winnings. Note that lottery winnings from other States are still taxable in California.
5. Federal law allows a deduction for **qualified higher education expenses**. California does **not**.
6. California treats **capital gains as ordinary income**. It does not provide special tax rates for capital gains. It does not permit capital loss carry backs. Amounts are not dependent on holding periods.
7. Federal law allows an exclusion of **foreign earned income**. California does not conform to Federal law and taxes residents on income from all sources including earned income from foreign countries.
8. Federal law allows **real estate professionals** who materially participate in real property trade to deduct more than \$25,000 of passive losses. California does **not** - regardless of the level of participation.
9. New Federal laws allow **expensing of property** and equipment up to **\$500,000 for 2011**. California conformed to the old \$25,000 ceiling for 2002 but has **not** conformed thereafter.
10. California conforms to Federal rules for **Net Operating Loss (NOL)** except that no carrybacks are allowed.