NONCONFORMITY TO THE TCJA

The following is a list of the Tax Cuts and Jobs Act (TCJA) provisions to which California does not conform.

INDIVIDUAL NONCONFORMITY

- **Tax brackets:** California has its own tax rates and brackets, so we do not conform to any of the changes that apply under the TCJA.
- Educator expenses: California has never conformed to the federal \$250 adjustment to income of eligible educators for the out-of-pocket expenses of purchasing books and other classroom supplies. (R&TC §17072)
- Moving expenses: California will continue to allow these deductions, and employer reimbursements will continue to be excludible fringe benefits for California as well. However, as the UIC conforms to federal law, reimbursements will be subject to SDI and UI for California purposes. (R&TC §§17024.5, 17081, 17131, 23051.5)
- **Alimony:** California conforms to pre-TCJA IRC §71 and will still allow a deduction for the payor and inclusion in income for the payee. (R&TC §§17081, 17201)
- **Student loans:** California will not conform to the COD exclusion for debt discharged due to death or disability of a student. (R&TC §§17024.5, 17131)
- **Standard deductions:** California continues to have its own standard deduction amount, which is indexed annually for inflation. (R&TC §18501)
- Itemized deductions:
 - Deduction for state and local taxes: California still prohibits deductions for state, local, and foreign income, sales and use, war profits, and excess profits taxes. However, California does allow deductions for state and local real and personal property taxes, and does not conform to the \$10,000 limitation. (R&TC §\$17024.5, 17220)
 - Mortgage interest: California will continue to allow deduction for acquisition debt of \$1 million and equity debt of \$100,000 (not allowed for AMT) for a maximum of \$1.1 million. (R&TC §\$17024.5, 17201)
 - Charitable contributions: For California purposes charitable contributions will continue to be limited to 50% of federal AGI. This could create carryover differences for your clients who make large charitable contributions. (R&TC §§17024.5, 17201)
 - Casualty losses: Taxpayers will still be able to claim casualty losses on their California returns. (R&TC §§17024.5, 17201)
 - o **Miscellaneous itemized deductions:** California will continue to allow miscellaneous itemized deductions subject to 2% of federal AGI. (R&TC §§17024.5, 17076)
 - o **Phaseout:** California will continue to have a reduction to itemized deductions and personal exemption credits based on federal AGI. (R&TC §17077)
- Capital gains: California does not apply a lower rate for capital gains. (R&TC §17041)
- AMT: California conforms to the pre-TCJA federal AMT provisions with some modifications, has its own exemption and phaseout amounts, and does not conform to any of the TCJA changes. (R&TC §17062)
- **Kiddie tax:** A child's income will still be taxed at the parent's rate on the California return, while it will be taxed at trust rates on the federal return. (R&TC §17041)

- **Net operating losses:** California will still allow NOL carrybacks, and the California NOL is not limited to 80% of taxable income. (R&TC §§17276 et seq., 24416 et seq.)
- ACA individual mandate: California has never imposed a similar penalty.
- IRC §529 plan distributions: California will most likely not conform to the provision allowing nontaxable distributions from §529 plans for K–12 education expenses, or nontaxable rollovers from §529 plans to ABLE accounts. (R&TC §§17024.5, 17140.3)
- ABLE account changes: California does not conform to the ABLE account changes. (R&TC §17140.4)
- Living expenses of Congressional members: Because California generally conforms to IRC §162(a) as it read prior to the enactment of the TCJA, members of Congress would still be permitted to deduct \$3,000 per year of living expenses incurred while on official business in Washington, D.C., on their California return. (R&TC §§17024.5, 17270)
- **New due diligence requirements:** California does not conform to the new due diligence requirements for the head of household filing status. (R&TC §§17024.5, 19167)
- "Charitable" athletic contributions: California does not conform to the elimination of the charitable contribution deduction for contributions made to institutions of higher education for which the taxpayer receives the right to purchase tickets for seating at an athletic event. (R&TC §§17024.5, 17201, 23051.5)
- **Bicycle commuting:** California does not conform to the suspension of the exclusion for qualified bicycle commuting reimbursements. California has its own exclusion for an employee riding to and from work. (UIC §§13006, 13009(q), 13009.5; R&TC §17149)
- **Sinai Peninsula:** California does not conform to the extension of combat zone tax benefit treatment to members of the Armed Forces working in the Sinai Peninsula of Egypt, effective beginning June 9, 2015. (R&TC §§17142.5, 18571)

BUSINESS NONCONFORMITY

- **IRC §199A deduction:** California will not have a comparable deduction.
- **Reduction in corporate tax rates:** California has its own tax rates and brackets, so we do not conform to any of the changes that apply under the TCJA. (R&TC §23151)
- **Dividends received deduction:** California does not have a general dividends received deduction and does not incorporate or follow the federal dividend received deduction, so we do not conform to these changes. (R&TC §24402)
- Corporate AMT: California conforms to the pre-TCJA federal AMT provisions, with some modifications, and does not conform to the elimination of the corporate AMT. (R&TC §§23400, 23453, 23455, 23455.5, 23456, 23456.5, 23457, 23459)
- Contributions to capital: California does not conform to the modifications to the definition of contributions to capital, so those items that are now taxable income for federal purposes continue to be capital contributions for California. This will be an important difference to track. (R&TC §§23051.5, 24325)
- **Increased bonus depreciation:** California has never conformed to bonus depreciation. (R&TC §§17250, 24349)
- Increased IRC §179 expensing: California will not increase §179 expensing. (R&TC §§17255, 24356)
- **Listed property:** California will not conform to the increased depreciation limitation for listed property, and computers and peripheral equipment will continue to be listed property for California purposes. (R&TC §§17024.5, 17201, 23051.5, 24349.1)
- **Real property recovery periods:** California has never offered 15-year depreciation for qualified leasehold improvement, qualified restaurant, or qualified retail improvement property, and will not conform to the TCJA changes in this area. (R&TC §§17250, 24349)

- Entertainment expenses: California does not currently conform to the changes applicable to entertainment expenses. Items such as tickets to sporting events or the theater will continue to be deductible for California purposes, and meals provided for the convenience of the employer will not remain fully deductible. (R&TC §§17024.5, 17201, 23051.5, 24443)
- Research and experimental expenditures: As California has its own R&D credit. We will not conform to the requirement to capitalize research or experimental expenditures starting in 2022. This will further complicate the analysis for taxpayers analyzing the benefits of the Research Credit. (R&TC §§17024.5, 17201, 23051.5, 24365)
- Nondeductible penalties and fines: California does not conform to the expanded definition of nondeductible penalties and fines. (R&TC §§17024.5, 17201, 23051.5, 24343)
- **Sexual harassment settlements:** California does not conform to the limitation disallowing deductions for settlements subject to nondisclosure agreements. (R&TC §§17024.5, 17201, 23051.5, 24343)
- Employee achievement awards: California does not conform to the changes to the definition of what qualifies as an employee achievement award. (R&TC §§17024.5, 17201, 23051.5, 24443)
- Employer-provided Family Leave Credit: California does not offer a similar credit.
- IRC §1031 only for real property: California does not conform to the provision limiting §1031 exchanges to real property. (R&TC §§17024.5, 18031, 23051.5, 24941) As a result, a taxpayer who trades in a business-use vehicle will have a §1031 exchange for California purposes but not for federal purposes.
- Excess business losses: California did not conform to the excess business losses under the previous law and does not conform to the changes. (R&TC §17560.5)
- Transportation fringe benefits: California has its own definition of transportation fringe benefits, and those benefits continue to be deductible for California purposes. (R&TC §§17024.5, 17090, 23051.5, 24443)
- **Self-created property:** California does not conform to the provision that excludes certain self-created property from the definition of a capital asset. (R&TC §§17024.5, 18151, 23051.5, 24990)
- New Markets Tax Credit: California does not offer a similar credit.
- **Technical termination rules:** California does not conform to the repeal of the technical termination rules. (R&TC §§17024.5, 17851, 23051.5)
- Carried interest: California does not conform to the increase in the holding period from one to three years to qualify for long-term capital gain when exchanging a profits interest for service. (R&TC §17024.5)
- Excessive employee compensation: California does not conform to the provision expanding the limitation on deductions of excessive compensation for publicly held corporations. (R&TC §§17024.5, 23051.5)
- **Business interest:** California does not conform to the limitation on the net interest expense deduction for businesses that do not qualify as small businesses. (R&TC §§17024.5, 17201, 23051.5, 24344)
- Accounting methods: California does not conform to the increased gross receipts limit allowing additional C corporations or partnerships with corporate partners to use the cash method of accounting. This means some taxpayers who will now be permitted to use the cash method of accounting for federal purposes must continue to use the accrual method for California purposes. (R&TC §§17024.5, 17551, 23051.5, 24654)
- **Domestic production activities deduction repeal:** California has never conformed to the IRC §199 domestic production activity deduction. (R&TC §17201.6)
- **Repeal of rehabilitation credit for pre-1936 buildings:** California did not offer a similar credit.

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- Local lobbying expenses: California does not conform to the repeal of the deduction for these expenses. (R&TC §\$17024.5, 17201, 23051.5, 24343)
- Reduction of credit for orphan drugs: California no longer allows a similar credit.

Practice Pointer

With all of these additional nonconformity issues, it has become increasingly important to make sure that your software is handling the differences properly. Don't just assume that your software will get it right.

Make note of the important differences that apply to your clients, and be sure they are treated properly on those returns.

At Spidell's Federal and California Tax Update seminar, you will get our Quick Guide to California Nonconformity that will be updated to include these California changes.