January 16, 2010

Dear Tax Client:

Once again we come to the end of another year, and once again new tax laws have been added on top of the old ones, like a pile of garbage that just keeps getting bigger until someone finally decides to haul it away and start fresh. From a tax policy perspective, the new administration does not appear any different from prior administrations, which means it will continue to be more difficult for individuals to prepare their own tax returns. This next month, we will be taking update classes to better understand the tax implications of this year's legislation. Below are some of the highlights of the new tax legislation and key numbers as adjusted for inflation.

<u>First-Time Homebuyer Credit</u>: From January 1, 2009 until April 30, 2010, there is a refundable credit for qualified first-time home buyers purchasing a principal residence equal to 10% of the home's purchase price up to a maximum of $8,000. To qualify, the buyer(s) cannot have owned a principal residence within three years of the date of purchase. There are income limits as well as purchase price limits that apply to this credit. A second type of homebuyer credit, which is effective from November 6, 2009 to April 30, 2010, grants a maximum credit of $6,500 for those that are purchasing a new principal residence even though they have owned a principal residence in five of the last eight years.

<u>Reduced Home Sale Exclusion</u>: For sales after December 31, 2008, the $250,000 ($500,000 if married filing joint) exclusion of the gain on the sale of your primary residence will be reduced if there is any non-qualifying use occurring after December 31, 2008, such as rental or business use.

<u>IRA and Pensions</u>: In 2009, the maximum deduction for IRA contributions is $5,000, or $6,000 for those 50 and older. The salary deferral for pensions is between $11,000 and $22,000, depending on age and plan type.

<u>Suspension of IRA RMD</u>: Required Minimum Distributions from IRAs and other defined contribution qualified plans are suspended for 2009. If you have already taken the minimum distribution for 2009, you might be able to redeposit the funds if you are within the 60-day window of having taken the distribution.

<u>Auto Mileage Rates</u>: For 2009, the mileage rates per-mile are $0.55 for business use, $0.14 for charity work, and $0.24 for medical and moving expenses.

<u>Depreciation</u>: The Section 179 expensing election on the federal level remains a maximum of $250,000 for 2009, but the California maximum expense election remains at $25,000. On federal returns for 2009, we have the return of the 50% bonus depreciation, which allows businesses to immediately deduct half of the cost of new qualifying personal property.

S-Corporation Shareholders: As of January 1, 2009, more than 2% shareholders of an S-Corporation, along with spouses and dependent children, can no longer benefit from Section 125 plans (aka Cafeteria Plans or Flexible Spending Plans).

Education: For 2009 and 2010, the HOPE credit has been replaced with the American Opportunity Credit, which is a maximum credit of $2,500 per student, based on 100% of the first $2,000 of tuition, books, supplies and necessary equipment plus 25% of the next $2,000. As an alternative, the above-the-line deduction of $4,000 as well as the Lifetime Learning Credit remain in effect for 2009.

Teachers: For 2009, Congress renewed the $250 above-the-line deduction for educational supplies purchased by a qualifying educator.

Property Tax Deduction: An additional standard deduction is available for real property taxes paid by non-itemizers of up to $500 for single filers and up to $1,000 for joint filers.

Sales Tax Deductions: The deduction for state and local general sales tax was extended through 2009, so continue tracking the sales tax paid on large ticket items like vehicles and home improvements. For qualifying new vehicles purchased between February 17, 2009 and December 31, 2009, the sales tax paid can be added to your itemized or standard deductions.

Kiddie Tax: For 2009, dependent children under age 19, or under the age of 24 if a full-time student, with more than $1,900 in taxable investment income will pay tax on the excess at their parent's rates. To complicate things further, California still uses the pre-2006 rules, which only affect children under the age of 14.

Capital Gains and Dividends: The current maximum federal rates, which vary depending on the type of asset sold, are in effect through 2010. For 2008 through 2010, there is a 0% rate (yes, zero) for capital gains and qualified dividends included in taxable income of $33,950 or less when filing single and $67,900 or less when married filing a joint return.

Residential Energy Credits: For 2009 and 2010, homeowners may qualify for a 30% credit up to a maximum of $1,500 on the purchase of qualifying energy-efficient improvements to their primary residences, such as adding insulation, energy-efficient exterior windows and doors, and energy-efficient heating and air conditioning systems. This credit does not apply to homes in the process of being built or to the installation costs of the improvement, and all equipment or materials installed must be new. A separate 30% credit that is not subject to a cap and that can be used for second or newly constructed homes applies to the purchase of solar hot water heaters or electrical equipment, geothermal heat pumps, or wind turbines.

Alternative Fuel Credit: A credit for purchasing hybrid vehicles is still in effect for 2009 and 2010, though the amount depends on the make, model and date purchased. Credits on hybrid vehicles produced by some manufacturers, like Toyota, have already expired since the credit is limited to the sale of the first 60,000 units per manufacturer.

Plug-in Electric Drive Vehicle Credit: Beginning January 1, 2009, a new credit for buying plug-in hybrid electric vehicles will start at $2,500 and cap at $7,500, based on the battery capacity. Only the first 250,000 of these vehicles sold will receive the full credit before it starts to phase out. Qualifying vehicles must be newly purchased, have at least four wheels, have a gross vehicle weight of less than 14,000 pounds, and derive its propulsion from a battery with at least 4 kilowatt hours that can be charged with an external electrical source. A smaller 10% credit with a maximum of $2,500 is available for the purchase of plug-in vehicles between February 18, 2009 and December 31, 2011 that are either low-speed or have only two or three wheels

Making Work Pay Credit: For 2009 and 2010, this credit is equal to 6.2% of earned income with a limit of $400 for single filers and $800 for a married couple filing a joint return. However, for wage earners, this credit was included in the revised withholding tables starting in April 2009, so the reduction in federal withholding means the benefit was received during the year and not necessarily on the tax return. For pension recipients relying on the federal tables, this could mean an unwanted reduction in withholding since they may not be eligible for the corresponding credit. Most people who received social security benefits, pension benefits or railroad retirement benefits were eligible instead for a $250 one-time payment earlier in 2009.

Unemployment Compensation Exclusion: Every taxpayer receiving unemployment benefits in 2009 will be allowed to exclude the first $2,400 of benefits from income.

Charitable Contributions: Extending through 2009, you can make up to $100,000 in tax-free distributions directly to charities from your IRA if you are at least age 70½. For other charitable contributions, last year's rules remain in effect: used clothing or household items must be in "good" condition to have charitable value, all items worth $5,000 or more require an appraisal, deductions for cash donations require a written receipt or a canceled check, but all cash donations of $250 or more require a written receipt.

CA Head-of-Household Credit: California now has a credit for qualifying taxpayers who are seniors filing as head-of-household or parents filing as single but who have joint custody of one or more children.

Foreign Bank and Financial Accounts: This law has been around awhile, but lately the IRS seems more determined to get full compliance. Anyone with a financial interest or signature authority over one or more accounts in a foreign country with an aggregate of more than $10,000 in value at any time during the calendar year must file Form TDF 90-22.1 by the following June 30th.

Keep in mind that your own tax situation can be different from anyone else's. We would be happy to consult with you on how these changes might affect you specifically and help you plan to reduce your taxes before the year is over.

May your Holiday and New Year celebrations be joyous ones.

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