

**PALOMAR CHAPTER
CALIFORNIA SOCIETY OF
ENROLLED AGENTS**

TAX YEAR 2009

**FEDERAL & CALIFORNIA
UPDATE**

JOHN W. HAGGERTY III, MBA, EA

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2009 TAX YEAR UPDATE

MAJOR FEDERAL TAX ACTS 2001 to 2009

2001: The Economic Growth and Tax Relief Reconciliation Act, EGTRRA, included tax rate reduction, estate tax repeal, marriage penalty relief, education incentives, increased child tax credit, increased IRA's, pension reform, and some AMT relief. All of its provisions are set to expire on December 31, 2010 and tax law will revert to those in effect prior to EGTRRA.

2002: The Job Creation and Worker Assistance Act included a 30% first year bonus depreciation, five-year carry back of 2001 and 2002 net operating losses, and an above the line deduction for teachers classroom expenses.

2003: The Jobs and Growth Tax Relief Reconciliation Act, JGTRRA, increased first year bonus depreciation to 50%, reduced tax rates for capital gains and dividends, and increased Section 179 expensing.

The Military Family Tax Relief Act of 2003 provided an election to suspend for up to 10 years the five year test period for the exclusion on the sale of a personal residence; an above-the-line deduction for over-night travel expenses for reserve and National Guard members; and an exclusion from gross income of certain death gratuity payments.

2004: The Working Families Tax Relief Act of 2004, WFTRA '04, extended through 2010 the expanded 10% tax bracket, marriage penalty relief, and the \$1,000 child tax credit. WFTRA redefined "dependents" and "qualifying child".

The American Jobs Creation Act of 2004, JOBS '04, phased out the export tax break and replaced it with Section 199 Domestic Production Deduction; disallowed Section 121 exclusion for sale of a principal residence acquired in a like-kind exchange within five years earlier; limited Section 179 expensing for SUV's ; reformed S Corp taxation and increased permissible number of shareholders; tightened rules on charitable deductions for vehicle donations; allowed itemized deductions of state and local sales taxes in lieu of deductions of state and local income taxes; and modified foreign tax credit rules.

2005: The Energy Tax Incentives Act of 2005 provided tax incentives over 10 years to boost conservation efforts, increase domestic energy production, and expand the use of alternative energy sources.

2006: The Heroes Earned Retirement Opportunities (HERO) Act allows members of the armed forces to count tax-free combat pay as earned income in determining IRA contribution amounts.

The Pension Protection Act of 2006 strengthened pension plans, added new and enhanced retirement savings incentives, and changed numerous rules on charitable giving, IRA's, and 401(k)s.

The Tax Relief and Health Care Act of 2006 (TRHCA) extended some expiring popular tax cuts and energy credits and enhanced Health Savings Accounts.

2007: The Small Business and Work Opportunity Tax Act of 2007 provided tax incentives for small businesses; increased age for the kiddie tax; and increased and expanded return-preparer penalties.

The Mortgage Forgiveness Debt Relief Act of 2007 excluded from income discharges of up to \$2 million acquisition indebtedness on a principal residence for 2007 through 2009; extended mortgage insurance premiums as deductible mortgage interest; and expanded Section 121 to exclude gain up to \$500,000 on the sale of a qualifying principal residence by a surviving spouse within 2 years after the spouse's death.

2008: The Economic Stimulus Act of 2008 provided refundable rebates to individuals; doubled the limits for Sec. 179 expensing of qualified property in 2008; and re-instituted bonus depreciation for qualifying property placed in service in 2008.

The Heroes Earning Assistance and Relief Act (HEART) of 2008 enabled active-duty military personnel filing jointly to qualify for economic stimulus payments if the service member has a SSN, even if the spouse does not; and included tax breaks for military who are receiving combat pay, saving for retirement, or purchasing homes.

The Housing and Economic Recovery Act of 2008 provided first-time home buyers with a refundable tax credit and provided an additional standard deduction for state and local property taxes paid by taxpayers who claim the standard deduction. It also amended IRC Section 121 making gain on the sale of a principal residence allocated to periods of nonqualified use not eligible for exclusion.

The Worker, Retiree, and Employer Recovery Act of 2008 suspended required minimum distributions from 401(k) plans, IRAs, and similar retirement accounts for 2009 and provided pension plan funding relief for single- and multi-employer plans.

The Adoptions Act of 2008 clarified the uniform definition of a child.

2009: The American Recovery and Reinvestment Act of 2009 (ARRA-09) signed February 17, 2009 included a new Making Work Pay Credit; extended and enhanced many other tax credits, depreciation, expensing, AMT relief; and a five year NOL carry-back for small businesses; allowed deduction of state and local taxes paid on purchase of a new automobile in 2009; and suspended tax on the first \$2,400 of unemployment benefits paid in 2009.

The Worker, Homeownership, and Business Assistance Act of 2009 signed November 6 extended and expanded the home purchase credit and extended the five-year NOL carry-back to all US businesses.

The Military Spouses Residency Relief Act signed November 11, 2009 restricts non-resident state taxation of spouses of US military members who accompany their military spouse when stationed outside their home state.

THE UNIFORM DEFINITION OF A CHILD now includes:

- Child must be younger than the claimant and
- Child has not filed a joint return for the tax year other than for a claim of refund.
- If parent(s) do not claim a qualifying child, any other claimant must have higher AGI than qualifying parent(s).

ALTERNATIVE MINIMUM TAX: AMT Exemption Amounts were increased in ARRA-09 for 2009:

	<u>2009</u>	<u>2010 & Later</u>	<u>Phase-out Threshold</u>
MFJ & QW	\$70,950	\$45,000	\$150,000
Single, HH	\$46,700	\$33,750	\$112,500
MFS	\$35,475	\$22,500	\$ 75,000

Offset of non-refundable personal tax credits against both regular tax and AMT was extended for 2009. The credits include the child tax credit, dependent care credit, adoption credit, credit for elderly and disabled, saver's credit, credit for interest on certain home mortgages, Hope and Lifetime Learning credits, credit for certain non-business energy property, and, beginning 2009, the alternative motor vehicle credit .

Credit Against Regular Tax for Prior Year Minimum Tax (Form 8801).

Taxpayers are permitted a credit against regular tax liability for some or all of AMT paid in prior years, including that paid on the exercise of incentive stock options and 50 percent of the penalties and interest paid on the ISO AMT liability.. The credit is allowed for the amount of "adjusted net minimum tax" for all tax years reduced by the minimum tax credit claimed for all prior tax years (Code Sec 53). The credit may be carried forward indefinitely as a credit against regular tax.

The credit is limited to the extent regular tax liability, reduced by other nonrefundable credits, exceeds AMT. Credit for unused minimum tax credit carryover from 2005 or earlier years may be refundable. The minimum tax credit is allowed only for AMT caused by incentive stock options and deferral items (for example depreciation) and not by exclusion items (for example itemized deductions or certain tax-exempt interest).

LONG TERM CAPITAL GAINS: Qualified dividends will be included in capital gains through 2010.

	<u>2009-2010</u>	<u>After-2010</u>
Capital gains rate generally*	15%	20%
Capital gains rate for taxpayers in 10% and 15% tax brackets	0%	10%

- The maximum 28% rate applies for collectibles, and for net gain from small business stock when the Section 1202 exclusion is elected. The maximum 25% rate applies for unrecaptured Section 1250 gain. After 2010 the special 2% lower capital gains rates on 5-year property will again apply.

Alternative Minimum Tax. The same capital gain rates used to compute regular tax are used when computing AMT.

Investment interest expense. Capital gain income is not included in investment income for purposes of calculating investment interest expense deduction unless specifically elected by the taxpayer. If such election is made, that amount of capital gain will not be eligible for the capital gain tax rates.

Qualified Dividends. Stock dividends received from domestic or qualified foreign corporations, including those passed through to investors by a mutual fund or other regulated investment company, partnership, real estate investment trust, or common trust fund. For the capital gains tax rates to apply, an investor is required to hold a stock for at least 61 days in the 121-day period beginning 60 days before the ex-dividend date.

In the case of preferred stock, the stock must be held for 91 days during the 181-day period beginning 90 days before the ex-dividend date.

Small business stock exclusion. The exclusion from gain on the sale of small business stock acquired after February 17, 2009 and before January 1, 2011 is increased from 50% to 75% by ARRA-09. This stock must be “tagged” for future tax benefit.

FARMERS AND FISHERMEN;

The period allowed for replacement of livestock involuntarily sold due to weather conditions is 4 years. Income averaging is available to farmers and commercial fishermen and both use Schedule J (Form 1040).

SECTION 179 EXPENSING FOR SMALL BUSINESSES INCREASED:

- For 2009 the Section 179 limit is \$250,000 (\$134,000 for 2010) and the phase-out threshold \$800,000 (\$530,000 for 2010).
- Section 179 expensing on SUV's 14,000 pounds gross vehicle weight or less remains limited to \$25,000.
- Off-the-shelf computer software qualifies for Section 179 expensing.
- Taxpayers may make or modify elections with regard to Code Section 179 elections without IRS consent on originally filed or timely filed amended returns.

BONUS DEPRECIATION:

50-percent first year bonus depreciation has been extended for qualifying property with a depreciation period of 20 years or less and placed in service in calendar year 2009. The placed-in-service date is extended through 2010 for certain property with longer production periods and for certain noncommercial aircraft.

IMPROVEMENTS TO LEASED NON-RESIDENTIAL REAL PROPERTY, RESTAURANT PROPERTY, AND RETAIL PROPERTY:

Qualified leasehold improvement property and qualified restaurant improvement property which were placed in service after October 22, 2004 and before January 1, 2010 generally have 15-year MACRS straight line recovery periods similar to Section 197 intangibles rather than 39-year MACRS recovery periods. Similarly, a 15-year recovery period is also authorized for depreciation of qualified improvements to the interior portion of a building used for a retail business in a building at least three years old when the improvements are placed in service.

START-UP AND ORGANIZATIONAL COSTS:

Taxpayers may elect to amortize start-up and organizational costs over a period of not less than 180 months. In the first year of business taxpayers may elect to deduct up to \$5,000 of start-up or organizational expenses. The \$5,000 amount is reduced, not below zero, by the amount by which the total start-up or organizational costs exceed \$50,000.

The remainder of the start-up or organizational costs must be ratably amortized over the 180 month period beginning with the month active trade or business begins.

E-FILING:

Practitioners may e-file individual returns only if the returns are signed electronically using either the self-select PIN or the practitioner PIN method. Form 8879 must be signed by the taxpayer and retained by the ERO for 3 years. Form 8453 will be used only to transmit supporting paper documents listed on the form to IRS.

IRS has warned practitioners not to e-file returns prior to receipt of all forms W-2, W-2G, and 1099-R for a taxpayer.

The Worker, Homeowner, and Business Assistance Act of 2009 requires that any individual income tax return filed by a tax return preparer after December 31, 2010 be filed electronically unless the preparer reasonably expects to file 10 or fewer individual income tax returns during the calendar year. For this purpose the term individual return includes any return imposed by subtitle A on individuals, estates, or trusts.

CHARITABLE DONATIONS OF CASH, regardless of amount, must be substantiated by a bank record or a receipt, letter, or other written communication from the charitable organization.

CHARITABLE DONATIONS OF CLOTHING AND HOUSEHOLD ITEMS are not deductible unless the items are in “good” or better condition. Taxpayers must be able

to prove the condition and value. An exception can be made for items not in good or better condition but worth more than \$500 with a qualified appraisal. Household items include furniture, furnishings, electronics, appliances, linens, and similar items. Donations of food, painting, antiques, objects of art, jewelry, gems, and collections are not subject to these restrictions.

CHARITABLE DEDUCTIONS OF MOTOR VEHICLES, BOATS, AIRCRAFT:

If the claimed value of a donated “qualified vehicle” exceeds \$500, the taxpayer must include in the tax return a contemporaneous written acknowledgement of the donation. A “qualified vehicle” includes any motor vehicle manufactured primarily for use on public roads or highways, a boat, or an aircraft, but does not include any inventory property. The acknowledgement must be provided to the donor within 30 days of the date of the donation **or** of the date of sale of the qualified vehicle by the donee organization. The acknowledgement must contain:

1. The name and taxpayer identification number of the donor;
2. The condition of the vehicle and its identification number;
3. If the vehicle is sold by the donee organization, a certification that it was an arms-length sale, the gross proceeds of the sale, and a statement that the deductible amount by the donor may not exceed the gross proceeds of the sale; or
4. If the donee organization retains the vehicle for its own usage, a certification of its intended use or material improvement, and that it will not be transferred in exchange for money, property, or services prior to completion of the intended use or improvement.

TAX-FREE DISTRIBUTIONS UP TO \$100,000 FROM IRA’S TO CHARITIES can be made by taxpayers age 70½ or older in 2009. The distribution will not be included in income and must be a direct rollover from the IRA trustee to the charity. Transferred amounts are considered as coming first from taxable funds, including required minimum distributions, are not added to AGI, and no itemized deduction is available for the amount transferred.

ALTERNATIVE MOTOR VEHICLE CREDIT, IRC Sec 30B (Form 8910):

Purchasers or lessors, private or commercial, of hybrids or “lean-burn” vehicles may be entitled to the Alternative Motor Vehicle Credit. The credit is equal to the sum of the separate components. There are three requirements common to all of the components:

1. The original use of the vehicle commences with the taxpayer,
2. The vehicle is acquired for use or lease by the taxpayer and not for resale, and
3. The vehicle is made by a manufacturer.

The components of the Alternative Motor Vehicle Credit are:

(1) Qualified Fuel Cell Motor Vehicle Credit. Credit for a certified vehicle propelled by power derived from one or more cells which convert chemical energy directly into electricity by combining oxygen with hydrogen fuel. The basic credit ranges from \$8,000 (\$4,000 after 2009) to \$40,000 depending on gross vehicle weight. An additional credit of \$1,000 to \$4,000 is available for fuel cell passenger vehicles or light trucks which meet certain standards of increased fuel efficiency. The credit terminates for vehicles purchased after 2014.

(2) Advanced Lean Burn Technology Motor Vehicle Credit. Eligible vehicles must be certified passenger automobiles or light trucks with an internal combustion engine which is designed to operate primarily using more air than necessary for complete combustion, incorporates direct injection, and achieves at least 125 percent of the 2002 model year city fuel economy. The credit amount, depending on rated fuel economy, ranges from \$400 to \$2,400. An additional conservation credit of \$250 to \$1,000 is available for lifetime fuel savings. The credit is phased out over five quarters after the sale of the first 60,000 qualifying vehicles of all models (not each model) produced by that manufacturer.

(3) Qualified Hybrid Motor Vehicle Credit. Qualified vehicles must draw propulsion energy from onboard sources of stored energy that are both an internal combustion or heat engine using consumable fuel and a rechargeable energy storage system. The credit based on fuel economy ranges from \$400 to \$2,400 and an additional conservation credit amount for lifetime fuel savings ranges from \$250 to \$1,000. The credit will terminate for passenger automobiles and light trucks of not more than 8,500 pounds purchased after 2010 and for any other vehicle purchased after 2009. The credit is phased out over five quarters for qualifying vehicles purchased after the calendar quarter in which the manufacturer records its 60,000th sale of qualifying vehicles (total of all models):

1 st Quarter	100% of credit
2 nd & 3 rd Quarters	50% of credit
4 th & 5 th Quarters	25% of credit
After 5 th Quarter	No credit

(4) Qualified Alternative Fuel Motor Vehicle Credit. Qualified vehicles must be only capable of operating using an “alternative fuel”, defined as compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, and any liquid at least 85% of the volume of which consists of methanol. This definition does not include ethanol or other alcohol as does the definition of “clean fuel”. The credit amount is 50% of the incremental cost of the alternative fuel vehicle over the cost of the manufacturers suggested retail price for a gasoline or diesel fuel motor vehicle of the same model. An additional 30% credit is available if the vehicle is certified as meeting or exceeding the most stringent standards available. A reduced mixed-fuel credit is available for vehicles that use a mixture of alternative fuel and petroleum-based fuels. The credit terminates for vehicles purchased after 2010.

(5) Plug-in Electric Drive Vehicles Credit (Section 30D): A new credit which applies to plug-in electric drive vehicles placed in service in 2009 –2014.

For four wheeled vehicles purchased in 2009, the credit is \$2,500 plus \$417 per kilowatt hour of traction battery capacity exceeding four kilowatts. The maximum credit is \$7,500 for a vehicle of 10,000 pounds or less, up to \$15,000 for a vehicle weighing more than 26,000 pounds. The credit would begin to phase out when the manufacturer sells 250,000 new qualified electric drive vehicles for use in the US after 2008. The credit is available to both individuals and businesses.

For four wheeled vehicles purchased after 2009 the credit amount is limited to \$7,500 regardless of weight and is phased out after 200,000 vehicles sold by a manufacturer for use in the US after 2009.

A new 10% of cost tax credit up to \$2,000 has been added for plug-in electrically powered two-wheeled, three-wheeled, and low speed vehicles purchased in 2009 – 2011.

Also another new 10% of cost tax credit up to \$4,000 for 2009 –2011 has been added for converting any motor vehicle into a qualified plug-in electric-drive motor vehicle.

ALTERNATIVE FUEL VEHICLE REFUELING EQUIPMENT CREDIT Section 30C (Form 8911):

A credit of 50% for 2009 and 2010 (previously 30%) of the cost of installing qualified alternative fuel vehicle refueling property is authorized, limited to yearly cost amounts of \$2,000 for residential installation and \$50,000 for commercial installation (up from \$1,000 and \$30,000). Qualifying property includes storage tanks or dispensing units for alternative fuels and charging stations for electric cars. The credit will be available through 2010 for qualified alternative fuel vehicle refueling property. For qualifying property relating to hydrogen the credit is limited to 30%, the cost limit is \$200,000, and the credit expires after 2014.

RESIDENTIAL ENERGY PROPERTY CREDIT Section 25C (Form 5695):

The lifetime maximum tax credit of up to \$500 to individuals for residential energy property has been eliminated and replaced by a credit of 30% of the cost of installing qualified residential energy property in a taxpayers US principal residence up to a combined credit limit of \$1,500 for 2009 and 2010. There is no AGI limitation and the credit applies to:

- Insulation systems that reduce heat loss/gain.
- Exterior windows
- Exterior doors
- Metal and asphalt roofs
- High efficiency heating and air conditioning systems
- Biomass fuel stoves and water heaters

CREDIT FOR RESIDENTIAL ENERGY EFFICIENT PROPERTY Section 25D (Form 5695):

The non-refundable personal tax credit of 30% of the cost of eligible solar water heaters, solar electricity equipment (photovoltaic), fuel cell and wind turbine plants, and geothermal heat pumps placed in service in a taxpayer's United States residence, was extended by EESA through 2016. The residence does not have to be the taxpayer's principal residence. This residential alternative energy credit now offsets both AMT and regular tax. The credit is:

- Limited to \$2,000 per year per for each category of solar equipment. For solar electric property the annual credit cap is removed for 2009-2016.
- Limited to \$500 per year for each half kilowatt of capacity of fuel cell or wind turbine plants installed in the taxpayer's principal residence (\$4,000 annual maximum for wind turbines).
- Annual maximum credit for geothermal heat pumps is \$2,000 per individual and \$6,667 for all individuals in the residence.
- Not available for expenses related to swimming pools or hot tubs.
- Excess credits may be carried over to the following year.

BUSINESS ENERGY INCENTIVES:

Deduction for energy-efficient commercial building property Section 179D. A deduction of up to maximum \$1.80 per square foot of a U.S. commercial building for costs associated with energy efficient property installed in the building through 2013.

Homebuilder's credit for new energy-efficient homes Section 45L. An eligible contractor or manufacturer may claim a credit for qualified energy efficient U.S. homes sold through 2009. A \$2,000 credit applies for homes certified to have 50% energy savings over comparable homes. Manufactured homes may also qualify for a \$1,000 credit with a 30% or better savings.

Manufacturer's credit for energy efficient appliances. A credit for the manufacture of energy-efficient clothes washers, dishwashers, and refrigerators, separately calculated for each type of appliance, extended through 2010.

Business solar, fuel cell, and microturbine property credit. Extended through 2016.

Energy research credit. 20% energy research credit extended through 2009..

DEDUCTION OF STATE AND LOCAL SALES TAXES: The election to deduct state and local sales taxes instead of state and local income taxes has been extended through 2009.

DEDUCTION FOR SALES TAXES ON PURCHASE OF NEW VEHICLE IN 2009:

ARRA 09 provides that sales taxes paid on the first \$49,500 of purchase price per vehicle on the purchase of a new passenger automobiles, light trucks, or motorcycles GVW 8,500 pounds or less, or new motor homes on or after February 17, 2009 and before January 1, 2010 may be deducted as an itemized deduction or as an addition to the standard deduction. The deduction is not subject to AMT and is phased out for modified AGI between \$125,000 and \$135,000 (\$250,000 - \$260,000 MFJ)

FEDERAL FILING REQUIREMENTS

<u>Status</u>	<u>Gross Income</u> <u>2009</u>	<u>Gross Income</u> <u>2010</u>
Single	\$ 9,350	\$ 9,350
65 or older	10,750	10,750
Head of Household	12,000	12,000
65 or older	13,400	13,400
Married/Joint Return	18,700	18,700
One spouse 65	19,800	19,800
Both spouses 65	20,900	20,900
Married/Separate Return	3,650	3,650
Qualifying widow(er)	15,050	15,050
65 or older	16,150	16,150

DEPENDENT FILING REQUIREMENTS FOR 2009:

Under age 65 and not blind must file if individual has:

1. Unearned income over \$950 or
2. Earned income over \$5,700 or
3. Gross income more than larger of \$950 or earned income (up to \$5,400) plus \$300 or
4. Gross income of \$5 or more and spouse itemizes on a separate return.

Age 65 or older or blind must file if:

1. Unearned income:
 Single: Over \$2,350 (\$3,750 if 65 or older **and** blind)
 Married: Over \$2,050 (\$3,150 if 65 or older **and** blind) or
2. Earned income:
 Single: Over \$7,100 (\$8,500 if 65 or older **and** blind)
 Married: Over \$6,800 (\$7,900 if age 65 or older **and** blind) or
3. Gross income more than larger of
 Single: \$2,350 (\$3,750 if 65 or older **and** blind) or

Earned income (up to \$5,400) plus \$1,700 (\$3,100 if 65 or older **and** blind)
Married: \$2,050 (\$3,150 if 65 or older **and** blind) or
Earned income up to \$5,400) plus \$1,400 (\$2,500 if 65 **and** blind).

SECTION 199 DOMESTIC PRODUCTION DEDUCTION (Form 8903):

Code Section 199 provides taxpayers with a deduction which generally applies to qualified income from the sale of property manufactured significantly in the United States. The deduction is equal to the lesser of 6 percent (9 percent after 2009) of:

- (1) Taxable income (AGI in the case of an individual); or
- (2) Qualified production activities income (QPAI).

Qualifying activities include the manufacture of personal property such as clothing, goods, and food as well as software development, film and music production, the production of electricity, natural gas, or water, and construction, engineering, and architectural services.

QPAI, Qualified Production Activities Income, is defined as domestic production gross receipts (DPGR) less the sum of:

- (1) Cost of goods sold that are allocable to DPGR
- (2) Other deductions, expenses, or losses directly allocable to DPGR
- (3) A ratable portion of other deductions, expenses, or losses that are not directly allocable to DPGR or to another class of income.

QPAI is to be determined on an item-by-item basis. An item is property offered for sale that meets all of the requirements of Code Section 199(c), or that portion of the property that does meet all the requirements. What constitutes an item will be determined on a case-by-case basis, taking into account all of the facts and circumstances. For tangible personal property, the proposed regulations require that at least 20% of the property be produced in the US.

DPGR, Domestic Production Gross Receipts, is defined as the gross receipts derived by the taxpayer from the lease, rental, sale, exchange, or other disposition of qualifying production property which was manufactured, grown, or extracted in whole or in significant part within the US. Qualifying production property means tangible personal property; computer software; sound recordings; and film and video tape where at least 50% of compensation is for services performed in the United States. In addition, DPGR may include gross receipts from construction performed in the US, or engineering and architectural services performed in the US for projects in the US.

The taxpayer must be in the trade or business on a regular and ongoing basis, but it is not necessary that it be its prime trade or business.

DPGR does not include gross receipts from the sale of food or beverages prepared by the taxpayer at a retail establishment or the transmission of electricity, natural gas, or potable water. It also shall not include any gross receipts derived from property leased, licensed, or rented by the taxpayer for use by any related person.

Wage Limitation. The employers annual Section 199 deduction may not exceed 50% of the wages and elective deferrals shown on employee's W-2's by the employer for wages paid through the calculation period for those wages allocable only to the qualified production activity instead of all wages. W-2 income does not include self-employment income as reported on an individuals Schedule SE, guaranteed payments to partners, or payments to independent contractors.

OFFERS IN COMPROMISE:

Taxpayers making an offer in compromise must make partial payments to the IRS during the time their offer is pending. Lump sum offers having five or fewer payments require a 20% down payment. Taxpayers must maintain whatever proposed payment schedule they have requested or the entire offer is off and payments are accelerated. Offers received without the required partial payment will be returned as not process-able. If the IRS fails to respond to an offer within two years, the offer is deemed accepted.

FDIC-INSURED DEPOSITS FOR ALL ACCOUNTS NOW UP TO \$250,000:

FDIC now provides up to \$250,000 of deposit insurance per owner for all accounts through December 31, 2013. Keogh accounts are insured separately from IRA accounts up to \$250,000 per owner. Trust accounts are insured up to \$250,000 per beneficiary, subject to specific limitations and requirements. On January 1, 2014 the standard insurance amount will return to \$100,000 per depositor for all accounts except IRAs and certain other retirement accounts. To maximize insurance protection, call FDIC's hotline 1-877-275-3342 or visit FDIC's on-line deposit insurance calculator www.fdic.gov/edie/calculator.

DEPRECIATION LIMITS ON VEHICLES FIRST PLACED IN SERVICE IN 2009 (Rev Proc 2009-24) AND 2010:

	Automobiles		Light Trucks and Vans	
	2009	2010	2009	2010
1 st Year	\$2,960	\$3,060	\$3,060	\$3,160
50% bonus depreciation	8,000		8,000	
Total if 50% bonus applies	10,960		11,060	
2 nd Year	4,800	4,900	4,900	5,100
3 rd Year	2,850	2,950	2,950	3,050
Each Later Year	1,775	1,775	1,775	1,875

- A light truck or van is a passenger vehicle, including a minivan or SUV, that is built on a truck chassis and has a gross vehicle weight (GVW) of 6,000 pounds or less.
- Trucks and vans, including SUV's, with a loaded gross vehicle weight in excess of 6,000 pounds are exempt from the annual depreciation limits.

- Trucks or vans that are qualified non-personal use vehicles (modified in such a way that personal use is not likely to be more than de-minimus) are not subject to the annual depreciation limits.

STANDARD MILEAGE RATES:

	CENTS PER MILE	
	2009	2010
Business Miles	55.0	50.0
Depreciation included	21.0	23.0
Medical/Moving expense	24.0	16.5
Charitable use	14.0	14.0

The standard mileage rate for business miles may be used by employees or self-employed for operating both owned or leased automobiles, vans, pickups, or panel trucks for business purposes, except vehicles used for hire, such as taxicabs. Taxpayers using no more than four vehicles at a time can use the standard mileage rate.

MORTGAGE INSURANCE DEDUCTION, IRC Sec 163 (h) (E):

Taxpayers may take an itemized deduction for qualified mortgage insurance premiums paid with respect to mortgage insurance contracts issued after 2006 and paid in 2007 through 2010 in connection with acquisition of a qualified residence. The deduction is phased out at 10% for each \$1,000 (\$500 if MFS) or fraction thereof the taxpayer's AGI exceeds \$100,000 (\$50,000 if MFS). Qualified mortgage insurance is that provided by FHA, VA, Rural Housing Administration, or private mortgage insurance.

MORTGAGE FORGIVENESS DEBT RELIEF, IRC Sec 108 (a) (Form 982):

Exclusion from federal tax on up to \$2 million (\$1 million for MFS) of acquisition, construction, or substantial improvement indebtedness on a principal residence discharged on or after January 1, 2007 has been extended through 2012. The basis of the taxpayer's residence is reduced, but not below zero, by the amount of the debt forgiven.

FIRST-TIME HOMEBUYER CREDIT, IRC Sec 36(b) (Form 5405):

An individual who is a first-time buyer of a principal residence in the US is allowed a credit against tax. First-time homebuyer for purpose of the credit is an individual (including individual's spouse) who had no ownership interest in a principal

residence during the three-year period prior to the purchase of the home to which the credit applies.

The credit cannot be used for vacation or second homes. A principal residence for purpose of the credit includes a house, condominium, houseboat, mobile home; or stock held by a tenant-shareholder in a cooperative housing corporation.

For a home the taxpayer constructs, the effective purchase date is the first date the T/P occupies the home.

Original law. Housing Assistance Act of 2008:

- Credit 10 percent of the purchase price of a home up to \$7,500 (\$3,750 MFS)
- Purchase after April 8, 2008 and before July 1, 2009.
- Credit phased out for MAGI \$75,000-\$95,000 (\$150,000-\$\$170,000 for MFJ).
- For purchase made in 2009 before July 1, T/P may elect to claim credit on 2008 or amended 2008 tax return as purchased Dec 31, 2008, or claim on 2009 tax return.
- Repay Credit, interest-free, over a 15-year period starting two years after the date of purchase. Repayment by increasing the taxpayer's federal income tax by one-fifteenth (6 2/3 %) of the credit amount each year during the repayment period.

If home is sold or no longer used as a principal residence before the full credit is repaid, remaining balance becomes due on the individual's return for year of sale or change of use. Repayment amount cannot exceed amount of gain (if any) from the sale of the residence. For this purpose gain is determined by reducing the basis of the residence by the amount of credit that was not repaid before the sale or change of use.

No repayment in event of the owner's death.

No acceleration of repayment if the taxpayer acquires a new principal residence within two years of the date of sale or change of use.

No acceleration of repayment in the case of a transfer of the residence to a spouse, or former spouse in a divorce. Spouse or former spouse steps into the shoes of the transferor for purpose of repayment.

The credit cannot be taken if:

- Income exceeds the phase-out range.
- Home is purchased from a spouse, parent, child, or grandchild,
- T/P stops using the home as his/her main home.
- T/P sells the home before the end of the year.
- T/P is a nonresident alien.
- T/P is or was eligible for the District of 'Columbia first-time homebuyer credit in any taxable year.
- Home financing is from tax-exempt mortgage revenue bonds.
- T/P owned another main home at any time during the three year period before the date of purchase.

Revised law. ARRA-09.

- Purchases after December 31, 2008 and before December 1, 2009,
- Maximum credit increased to \$8,000 (\$4,000 MFS)
- Repayment provisions eliminated for taxpayers who own and live in the home for at least 36 months.

Second revised law: Worker, Homeownership, and Business Assistance Act 09:

- Retains maximum non-repayable \$8,000 (\$4,000 MFS) Credit as in ARRA-09
- Purchase period extended five months to April 30, 2010 (June 30, 2010 if in a binding contract by April 30, 2010).
- Members of US military and certain federal employees serving outside the US are granted additional year to make home purchase until April 30, 2011 (June 30, 2011 if in a binding contract by April 30, 2011).
- MAGI phase-out limits for homes purchased after November 6, 2009 increased to \$125,000 - \$145,000 (\$225,000 - \$245,000 MFJ).
- Purchaser must be at least age 18 and not a dependent.
- Purchase price must not be over \$800,000.
- T/Ps who purchase a home after November 6, 2009 must use new version of Form 5405. If T/P claims the credit on 2009 return must file on paper.
- For purchases made after December 31, 2009, T/P may elect to treat purchase date as December 31, 2009 and file for credit on 2009 tax return, or claim on 2010 tax return.
- Unmarried purchasers may allocate the credit among themselves..

Reduced credit for long-time residents. Worker, Homeownership, and Business Assistance Act of 2009.

- Reduced credit up to \$6,500 (\$3,250 MFS).
- Owned and lived in same principal residence for any 5 consecutive years during 8 year period ending on date of purchase of a subsequent principal residence.

SALE OF PRINCIPAL RESIDENCE ACQUIRED IN A LIKE-KIND EXCHANGE

Exclusion of gain under Section 121 on the sale of a principal residence does not apply if the residence was acquired in a like-kind exchange during the five-year period before the sale.

GAIN ON SALE OF PRINCIPAL RESIDENCE AFTER DEATH OF SPOUSE:

A surviving spouse who files as a single taxpayer may exclude gain up to \$500,000 on the sale of a principal residence after December 31, 2007 provided the sale occurs not later than 2 years after the spouse's death and the requirements for the \$500,000 exclusion under Section 121 were met immediately before the spouse's death.

EXCLUSION OF GAIN ON SALE OF PRINCIPAL RESIDENCE ALLOCATED TO NONQUALIFIED USE, IRC Sec 121 (b)(4):

Section 3092(a) of the Housing and Economic Recovery Act (H.R. 3221) amended IRC Section 121, to the effect that so much of the gain allocated to periods of nonqualified use after December 31, 2008 will not be eligible for IRC Section 121 exclusion.

Gain allocated to periods of nonqualified use shall be based on the ratio the aggregate periods of nonqualified use during the period such property was owned by the taxpayer bears to the period such property was owned by the taxpayer.

'Period of nonqualified use' is defined as any period (other than the portion of any period preceding January 1, 2009) during which the property is not used as the principal residence of the taxpayer or the taxpayer's spouse or former spouse.

Exceptions: The term **'period of nonqualified use'** does not include:

- Any portion of the 5-year period described in Section 121(a) which is after the last date that such property is used as the principal residence of the taxpayer or the taxpayer's spouse.
- Any period (not to exceed an aggregate period of 10 years) during which the five year period in Section 121(a) is suspended under the provisions of the Military Family Relief Act of 2003. Sec 121 (d)(9).
- Any other period of temporary absence (not to exceed an aggregate period of 2 years) due to change of employment, health conditions, or other unforeseen circumstances as may be specified by the Secretary.

Example: T/P has owned a home for ten years, rented it for three of those years after 2008, and satisfied the two of the last five years principal residence use and ownership requirements of Section 121. Upon sale he may only qualify for 70% (7/10) of Section 121 exclusion since 30% (3/10) may be disqualified use. If, however, the three years of rental use were within the five-year Section 121 period and were after the last date the T/P or T/P's spouse used the property as their principal residence, such rental use would not be 'disqualified use' and would not reduce the Section 121 exclusion.

Taxpayers who are considering moving back into their rental property for two years to qualify it for Section 121 exclusion need to be aware of the non-qualified use rules.

E-POSTCARD FORM 990-N:

Beginning May 15, 2008, most small tax exempt organizations whose gross receipts are normally \$25,000 or less must file Form 990-N, also known as the e-Postcard.

Previously these small organizations did not have an annual filing requirement.

The e-postcard is due by the 15th day of the fifth month after the close of the organization's tax year

Failure to file the e-Postcard 990-N for 3 years will result in the organization losing its tax-exempt status.

EXTENSION OF TIME TO FILE FOR PARTNERSHIPS, TRUSTS, AND ESTATES:

Temporary regulations have shortened what had been a six month extension period to five months for partnerships, trusts, and estates for returns due after January 1, 2009. The reason for the change is to allow partners and beneficiaries time to prepare their personal returns. The new extended due date will be September 15 vice October 15 for these returns.

C and S corporations continue to have a six-month extension period.

BENEFITS TO VOLUNTEER FIREFIGHTERS AND EMERGENCY MEDICAL RESPONDERS, IRC Section 139B:

The Mortgage Forgiveness Debt Relief Act of 2007 includes provisions that qualified state and local tax benefits and qualified payments (up to \$30 per month of service) to members of emergency volunteer responder organizations would not be included in gross income in tax years 2008-2010.

CASUALTY LOSSES (IRC Section 165):

Casualty loss "deductible" increases for 2009 only. The casualty loss floor increases from \$100 to \$500 for tax year 2009 only. Reverts to \$100 in 2010.

Disaster loss provisions enhanced beginning in 2008. For casualty losses in federally-declared disaster areas:

- The 10% of AGI limit is waived for 2008 and 2009
- Non-itemizers can take an additional standard deduction for net losses from federally declared disasters for both regular tax and AMT for tax years beginning after 2007.
- Qualified disaster losses occurring in 2008 and 2009 can be carried back five years and are deductible against regular tax and AMT.

- Taxpayers may expense qualified disaster expenditures to include those business related expenditures such as removal of hazardous material, removal of debris, repair of property, or demolition of structures.

MAKING WORK PAY CREDIT (IRC Section 36A) New Schedule M:

ARRA-09 added a new refundable credit for 2009 and 2010. Eligible individuals are allowed a credit equal to the lesser of:

- 6.2% of the taxpayer's earned income; or
- \$400 (\$800 MFJ)

Eligible individual is any individual except

- A nonresident alien;
- An individual who can be claimed as a dependent by another taxpayer;
- Any individual who does not include a Social Security number on the tax return. A joint return must include the Social Security number of at least one spouse. An IRS issued TIN does not qualify.

Income phaseout. The credit is phased out at 2% of the excess of the taxpayer's modified AGI over \$75,000 (\$150,000 MFJ). Modified AGI is AGI increased by amounts excluded under the foreign earned income exclusion and exclusion of income from American Samoa and Puerto Rico.

Reduction for economic recovery payments. Any credit otherwise allowed is reduced by any economic recovery payment received by recipients of Social Security, SSI, railroad retirement benefits, and veterans disability or pension benefits. It is also reduced by the refundable credits allowed certain government retirees.

Withholding problems. The government "prepaid" the credit by reducing withholding to account for the credit. This may result in underpayment of tax for many taxpayers, such as when both spouses work and claim "married" on their W-4s, an individual has multiple jobs, or an individual has withholding on a pension but does not have "earned" income. These same withholding problems will carryover into 2010.

ECONOMIC RECOVERY PAYMENTS:

Under ARRA-09 adult recipients of Social Security, railroad retirement, and veterans' disability or pension benefits plus all recipients of SSI received a one time payment of \$250 during 2009 if eligible for their benefits for any of the three months prior to enactment of ARRA-09, i.e. November and December 2008 and January 2009. Recipients were eligible for payment under only one program even if they qualified under more than one of these programs. The economic recovery payments are not treated as gross income.

GOVERNMENT RETIREE CREDIT New Schedule M:

Certain government retirees receive their own version of the \$250 economic recovery payment. Instead of a payment, government retirees from federal, state, or an instrumentality thereof, will claim a \$250 (\$500 if both spouses eligible) refundable credit on their 2009 tax returns. Any Making Work Pay Credit must be reduced by the amount of the Government Retiree Credit.

EXCLUSION FOR UNEMPLOYMENT COMPENSATION:

ARRA-09 provides for a one-year exclusion of up to \$2,400 of unemployment compensation received per recipient in 2009. There are no AGI limitations. Since the exclusion is per recipient, the exclusion is not automatically doubled on a joint return. For example if one spouse received \$5,000 of unemployment compensation and the other spouse received \$500, the exclusion would be \$2,400 plus \$500 = \$2,900.

MILITARY SPOUSES NON-MILITARY INCOME: Effective beginning 2009, under the tax-related provisions of the Military Spouse Residency Relief Act (MSRRA), a spouse of a service member is exempt from state income tax on income from services provided in a state if:

- The service member is present in the state in compliance with military orders.
- The spouse is in the state solely by reason of being there to be with the service member.
- The spouse maintains domicile in another state.

Individual states will have to issue guidance as applies to their state on how to request refunds and exemptions from withholding.

MSRRA applies only to the service member's spouse. The service member is covered by the federal Servicemembers Civil Relief Act.

NET OPERATING LOSS CARRYBACK Code Section 172:

- ARRA-09 authorized qualified small businesses with average gross receipts of \$15 million or less to carryback 2008 NOLs for three, four, or five years instead of the standard two years.
- Worker, Homeownership, and Business Assistance Act of 2009 authorizes all businesses to elect to carryback 2008 and 2009 NOLs for up to five years. The amount that may be carried back to the fifth preceding year is limited to 50 % of the taxable income for that preceding year. The election may be made for either 2008 or 2009 NOLs, but not for both years, except that qualified small businesses that made the election to carryback 2008 NOLs may elect to carryback both 2008 and 2009 NOLs for up to five years. The 50% limitation on the fifth preceding year does not apply to the 2008 small business NOL.

INDIVIDUAL RETIREMENT ACCOUNTS:

Limits on contributions to traditional deductible IRA's, traditional non-deductible IRA's, and Roth IRA's are coordinated. The total contributions to all IRA's by each taxpayer, not including rollovers, may not exceed the lesser of his/her earned income or the following limits per year. For married couples, the combined earned income of the two spouses is used for the earned income limit, regardless of the amounts earned by each individual spouse.

	Under Age 50	Age 50 or older
2009 and 2010	\$5,000	\$6,000

Under age 50 adjusted for inflation in \$500 increments.
Age 50 or older catch-up amount will remain at \$1,000.

Contributions to a traditional IRA may not be made for the year in which the taxpayer reaches age 70½ or for any later year.

Traditional Deductible IRA's:

An individual who is not an active participant in a qualified pension plan is not considered an active participant merely because the individual's spouse is an active participant. The maximum deductible for such individual is phased out at 2009 joint adjusted gross incomes between \$166,000 - \$176,000 (\$167,000 - \$177,000 in 2010).

If the individual is an active participant in a qualified pension plan, his/her maximum deduction is phased out between the following adjusted gross incomes, indexed for inflation for 2007 and later:

	Single Taxpayers	Joint Returns
2009	\$55,000-\$65,000	89,000-\$109,000
2010	\$56,000-\$66,000	89,000-\$109,000

Married filing separate who lived with spouse at any time during year: \$0 - \$10,000 all years.

Traditional Non-Deductible IRA's: There are no adjusted gross income limitations for contributions to traditional non-deductible IRA's.

Roth IRA's: Contributions may be made to Roth IRA's past age 70 1/2. The maximum yearly maximum contribution to a Roth IRA is phased out for taxpayers with AGI's as follows:

Single	2009 & 2010	\$105,000 - \$120,000
MFJ	2009 & 2010	\$166,000 - \$176,000

MFS (lived with spouse at any time during tax year - all years) \$0 - \$10,000

Roth IRA Conversion Rules.

For 2009, taxpayers with AGI's of \$100,000 or less generally may convert a traditional IRA into a Roth IRA. The amount converted is included in gross income as if a withdrawal had been made.

Minimum required distributions from IRA's are not included in computing the \$100,000 maximum modified AGI for determining eligibility for rollovers from traditional to Roth IRAs.

\$100,000 limit repealed in 2010. The \$100,000 modified AGI limitation is repealed in 2010. For conversions made in 2010, the converted amount may be all included in income in 2010 or half in income in 2011 and half in 2012, with none included in income in 2010.

In light of the liberalized rollover rules to take effect in 2010, taxpayers ineligible to contribute or convert to a Roth IRA for 2009 because of AGI limitations may consider contributing to a traditional non-deductible IRA. Then in 2010 convert the IRA to a Roth IRA.

RETIREMENT PLANS:

The Pension Act of 2006 made the EGTRRA 2001 retirement plan changes permanent, i.e. will not sunset after 2010.

Annual Compensation limit for qualified plans for purposes of determining benefits, employer contributions, and testing for nondiscrimination is \$245,000 for 2009 and 2010. The limit applies to qualified retirement plans, SEP's, and SIMPLE plans. For self-employed individuals, adjustments are required for one-half of self-employment tax plus the amount of the contribution.

Maximum annual benefit for defined benefit plans is \$195,000 for 2009 and 2010. This limit is reduced if benefits begin before age 62 and is increased if benefits begin after the full social security retirement age of 66.

Annual contribution limits to defined contribution (profit sharing/money purchase) plans. The sum of employer contributions, employee contributions, and forfeitures with respect to an individual under all defined contribution plans of the same employer, up to lesser of 100% of employee's annual compensation or \$49,000 both 2009 and 2010 (indexed for inflation in \$1,000 increments). Catch-up contributions if plan permits for taxpayers age 50 or over \$5,500 in 2009 and 2010. Contributions are required by due date of employer's return.

Annual employer deduction limits. The maximum deduction for contributions by the employer to profit-sharing plans, stock bonus plans, SEP's, and money purchase plans is 25% of aggregate compensation of all employees.

The aggregate dollar limits for elective deferral of compensation by employees for Code Sec 401(k) plans, Code Sec 403(b) tax sheltered annuities, Code Sec 408(k) salary reduction SEP's, and Code Sec 457 tax-exempt organization and state and local government plans for 2009 and 2010 are \$16,500 for under age 50 (indexed for inflation in \$500 increments) and \$22,000 for age 50 and over.

401(K) Roth Contributions. Taxpayers may designate all or part of their authorized deferral to 401(K) plans as after-tax Roth-like contributions which will have the same five-year tax-free distribution features as Roth IRA's. Separate accounting is required. Minimum required distributions are required after age 70½ the same as traditional pre-tax Section 401(K) plans.

Rollover of retirement plans to Roth IRA's. Distributions from eligible retirement plans (qualified trusts, TSA's, Sec 457 plans) made after December 31, 2007 can be rolled over directly into a Roth IRA under the same rules that apply to rollover from traditional IRA's to Roth IRA's as appropriate for 2009 or 2010 (\$100,000 AGI rules).

Code Sec 408(p) SIMPLE plan maximum contribution amounts for 2009 and 2010 for under age 50 \$11,500 and for age 50 and older \$14,000. Contributions due for Simple IRA by 30 days after end of month for which contributions are to be made; for Simple 401(k) by due date of employers return.

RETIREMENT SAVINGS CONTRIBUTION (SAVERS) CREDIT:

Taxpayers age 18 and older who are not a dependent of another taxpayer, are not a full-time student, and who contribute to an IRA or employer-sponsored retirement plan may be eligible for a non-refundable tax credit. The credit, now made permanent, is in addition to any deduction or exclusion from gross income for contributions to an IRA or qualified retirement plan. The credit is a percentage of the first \$2000 contributed if the taxpayer's adjusted gross income is within the following limits indexed for inflation:

Credit	Joint Return		Head of Household		All other cases	
	Over	Not over	Over	Not over	Over	Not over
Tax Year 2009:						
50%	\$0	\$33,000	\$0	\$24,750	\$0	\$16,500
20%	33,000	36,000	24,750	27,000	16,500	18,000
10%	36,000	55,500	27,000	41,625	18,000	27,750
0%	55,500		41,625		27,750	
Tax year 2010:						
50%	\$0	\$33,500	\$0	\$25,125	\$0	\$16,750
20%	33,500	36,000	25,125	27,000	16,750	18,000
10%	36,000	55,500	27,000	41,625	18,000	27,750
0%	55,500		41,625		27,750	

Contributions for purposes of the credit will be reduced by any withdrawals included in income from any of the above plans during the current tax year until the due date of the return including extensions and the two preceding tax years.

REQUIRED DISTRIBUTIONS FROM IRA'S AND PENSIONS:

Upon reaching age 70½ an individual uses his/her Life Expectancy for his age at the close each year from the UNIFORM LIFETIME TABLE to determine the minimum required distribution (MRD) from his/her IRA or pension plan.

When a spouse is more than 10 years younger than the individual, the individual may use the IRS JOINT LIFE EXPECTANCY TABLE if it results in a smaller MRD.

Post-death minimum required distributions from an IRA or tax-deferred plan are figured by using the life expectancy of the beneficiary as listed in the IRS SINGLE LIFE TABLE FOR INHERITED IRA'S for the year following the account owner's date of death. If there are more than one beneficiary to an account, the life expectancy of the oldest beneficiary is used.

Surviving Spouse: Special rules apply to surviving spouses:

- If the account owner died before reaching age 70½ the surviving spouse need not begin distributions before the deceased spouse would have reached age 70½.
- The surviving spouse may roll over an inherited IRA /qualified plan into his/her own IRA, in which case minimum distributions are not required until the surviving spouse attains age 70½. The rollover can be made at any time after the death of the account owner.
- If the surviving spouse is under age 59½ and desires to make penalty-free withdrawals, he/she may avoid the 10% early distribution penalties by not rolling-over the account into his/her own IRA until age 59 1/2, in the mean time use the SINGLE LIFE TABLE FOR INHERITED IRA'S.

Decisions on beneficiaries and post-death distributions must be made no later than September 30 of the year following death. If the first post-death MRD has not been taken by end of the year following the account owner's date of death, the entire account must be distributed no later than the last day of the fifth year following the year of death.

If there is no beneficiary and the account owner dies after the required beginning date for the MRD's, the account balance is paid out over what would have been the owners remaining life expectancy in the Uniform Lifetime Table to the individual's estate.

Non-spouse beneficiaries of a deceased person's qualified plan, Sec 403(b), or Sec 457 plan may rollover the decedent's interest into their own IRA trustee-to-trustee. The IRA will be treated as an inherited IRA and single life expectancy MRD rules will apply.

Minimum Required Distributions for 2009 from 401(k) plans, IRAs, and similar plans were suspended by the Worker, Retiree, and Employer Recovery Act of 2008.

EDUCATION INCENTIVES:

Above-the-line Tuition and Fees Deduction (Form 8917).

The above-the-line deduction from gross income for qualified higher education expenses of taxpayers whose modified AGI's do not exceed specified levels has been extended through 2009. Dependents and married filing separately may not take the deduction.

The deduction may not be claimed for students taking the Hope or Lifetime Learning credit in the same tax year. Also education expenses must be reduced by expenses deductible under any other provision, such as the tax-exempt portion of distributions from education savings bonds, Coverdell Education Savings Accounts, and qualified Section 529 tuition plans.

The deduction is a dollar-for-dollar amount up to a maximum indicated below. The deduction is not subject to an AGI phase-out but to a modified AGI limit. Even one dollar over the relevant modified AGI limit means no deduction can be claimed.

Deduction Limit	AGI Limit	AGI Limit MFJ
\$4,000	\$65,000	\$130,000
\$2,000	\$80,000	\$160,000

Coverdell Education Savings Accounts. A non-deductible contribution of up to \$2,000 per child under age 18 may be made to a Coverdell Education Savings Account. The allowable contribution is phased out for donors with modified AGI's of \$95,000-\$110,000 (\$190,000 - \$220,000 MFJ).

- There is no age limit for special needs children.
- Allowable expenses include elementary and secondary education, both public and private.
- Tax free distribution from a Coverdell educational savings account and a HOPE or Lifetime Learning credit may be claimed for the same student in the same year as long as the distribution is not used for the same expenses for which the credit is claimed.

Student Loan Interest Deduction. An above-the-line deduction of up to \$2,500 may be claimed for student loan interest paid during the tax year. The deduction is phased-out for taxpayers with modified AGI's:

2009	\$60,000-\$75,000	(\$120,000-\$150,000 MFJ).
2010	\$60,000-\$75,000	(\$120,000-\$150,000 MFJ).

Qualified tuition programs (Sec 529 Plans).

Qualified pre-paid tuition and savings programs may be offered by states. Eligible private educational institutions also may offer pre-paid tuition programs. Distributions from Section 529 plans used for qualified higher education are tax-free to the beneficiary. Qualifying expenses normally include tuition, fees, books, supplies, and equipment required for enrollment and attendance at the eligible education institution. For 2009 and 2010, ARRA-09 provides that computer technology and equipment, software, internet access, and related services qualify if used predominately for education.

Employer-provided educational assistance. The exclusion from gross income of employer-provided educational assistance up to \$5,250 per individual is permanent and includes graduate level education courses.

American Opportunity Tax Credit (Hope Credit):

For 2009 and 2010 The American Opportunity Tax (Hope) Credit is 100% of the first \$2,000 of eligible tuition and fees and required course materials and 25% of the second \$2,000, for a maximum credit of \$2,500 per student for the first four years of undergraduate education when enrolled on at least a half time basis leading to a degree, certificate, or credential. The credit is 40% refundable unless the student is subject to Kiddie Tax. The credit may offset AMT. Modified AGI phase-out range for 2009 and 2010 is \$80,000-\$90,000 (\$160,000-\$180,000 MFJ).

Lifetime Learning Credit remains at 20% of up to \$10,000 of eligible tuition and fees, for a maximum annual credit of \$2,000 per return (not per student). The modified AGI phase-out range for 2009 and 2010 is \$50,000-\$60,000 (\$100,000-\$120,000 MFJ).

Coordination rules for education incentives. Qualified expenses are first reduced for scholarships or fellowship grants excludable from gross income and any other tax-free education benefits. Expenses may then be taken into account in determining allowable Hope and Lifetime Learning credits.

SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS:

Modified Adjusted Gross Income thresholds for taxation of social security and railroad retirement benefits have not changed.

Foreign Social Security. Unless exempted by treaty, foreign social security is fully taxable. U.K. social security is not taxable to U.S. residents. Canadian Old Age Security (OAS) and Canada/Quebec Pension Plans (CPP/QPP) benefits paid to U.S. residents are taxable on the U.S. federal tax return as if they were benefits of the U.S. Social Security Act. All foreign social security is fully taxable to California.

	<u>2009</u>	<u>2010</u>
Wage Base	\$106,800	\$106,800
Old Age, Survivors, and Disability Insurance Tax	6.2%	6.2%
Maximum	\$6,621.60	\$6,621.60
Medicare Tax (no maximum)	1.45%	1.45%
Medicare B Monthly Premium*	\$96.40 to \$308.30	\$96.40 to \$308.30
Cost of Lining Adjustment	5.8%	0.0%
Household employees threshold	\$1,700	\$1,700
Yearly Earnings Ceilings:		
Under full retirement age**	\$14,160	\$14,160
Year T/P turns full retirement age***	\$37,680	\$37,680

* Depending on Medicare B premium surcharge. See next page.

** Forfeits \$1 social security for each \$2 earned over ceiling. Full retirement age is 66.

*** Earnings for full months prior to reaching full retirement age are subject to the earnings ceiling listed above. T/P forfeits \$1 of social security for every \$3 in earnings above the ceiling.

MEDICARE B PREMIUM SURCHARGE

Effective 1 January 2007 a surcharge was added to the basic Medicare B premium for individuals in higher income brackets. The surcharge is a percentage of the basic premium based on a prior year AGI plus tax exempt interest, EE Bond interest used for education, excluded foreign earned income, and income from sources in Guam, American Samoa, Northern Mariana Islands, and Puerto Rico.

Social Security recipients may appeal the surcharge determination and use income from a later year if their circumstances change due to a major event.

For 2009 the surcharge percentage rates are triple those for 2007 and will be based on 2007 income:

INDIVIDUAL	MFJ	SURCHARGE	TOTAL
\$85,000 or less	\$170,000 or less	-0-	\$ 96.40
\$85,001-\$107,000	\$170,001-\$214,000	\$ 38.50	\$134.90
\$107,001-\$160,000	\$214,001-\$320,000	\$ 96.30	\$192.70
\$160,001-\$213,000	\$320,001-\$426,000	\$154.10	\$250.50
\$213,001+	\$426,001+	\$211.90	\$308.30

For 2010 the surcharge rates are based on 2008 income. For individuals with income \$85,000 or less, if Medicare B premium was withheld from Social Security payments, there is no increase:

INDIVIDUAL	MFJ	SURCHARGE	TOTAL
\$85,000 or less	\$170,000 or less		
Medicare B withheld		-0-	\$ 96.40
Medicare B not withheld		\$ 14.10	\$110.50
\$85,001-\$107,000	\$170,001-\$214,000	\$ 58.30	\$154.70
\$107,001-\$160,000	\$214,001-\$320,000	\$124.60	\$221.00
\$160,001-\$214,000	\$320,001-\$428,000	\$190.90	\$287.30
\$214,001+	\$428,001+	\$257.20	\$353.60

TAX RELIEF FOR MILITARY:

Exclusion of gain on sale of principal residence. A member of the uniformed services or Foreign Service of the United States on qualified official extended active duty may elect to suspend for a period of up to ten years the five-year test period for exclusion of gain on the sale of a principal residence. The uniformed services include the Armed Forces and the commissioned corps of the National Oceanic and Atmospheric Administration and the Public Health Service. If the election is made:

- The five-year period ending on the date of sale or exchange of a principal residence does not include any period up to ten years during which the taxpayer or the taxpayer's spouse is on qualified extended active duty.
- Qualified extended active duty is any period of active duty pursuant to a call or order to such duty in excess of 90 days or for an indefinite period while: serving at a place of duty at least 50 miles away from the taxpayer's principal residence; or under orders compelling residence in Government furnished quarters.
- The election may be made with respect to only one property for a suspension period.

Death Gratuity Payments. Fully tax free.

National Guard and Reserve members who must travel more than 100 miles away from home and stay overnight to attend National Guard or Reserve meetings may deduct meals, lodging, and transportation expenses above-the-line. Deductions may not exceed the general Federal Government per diem rate for that locale.

FOREIGN EARNED INCOME (FORM 2555):

Foreign Earned Income Exclusion. Maximum income exclusion portion \$91,400 for full year 2009 (\$91,500 for 2010).

Foreign Housing Cost Exclusion. The maximum housing expense exclusion portion is 14% of the foreign earned income exclusion portion (\$12,796 for 2009, \$12,810 for 2010) unless taxpayer is living in a location for which the Secretary of Treasury publishes an adjustment to the limitation.

Tax computation for Foreign Earned Income Exclusion. TIPRA changed the tax computation for the foreign earned income exclusion to a method where the exclusion is computed at the lowest tax rates vice the highest tax rates.

ARCHER MEDICAL SAVINGS ACCOUNTS . No new MSA's after 2007

	Self-only		Family	
	2009	2010	2009	2010
Minimum deductible	\$2,000	\$2,000	\$4,000	\$4,050
Maximum deductible	\$3,000	\$3,000	\$6,050	\$6,050
Maximum out of pocket	\$4,000	\$4,050	\$7,350	\$7,400

HEALTH SAVINGS ACCOUNTS (Form 8889):

Health Savings Account (HSA) rules are more flexible than the MSA rules and may prove more favorable to employers and especially to young taxpayers than other health insurance plans. Similar to MSAs, HSAs must be linked to High Deductible Health Plans that have the following Limitations:

	Self-only		Family	
	2009	2010	2009	2010
Minimum deductible	\$1,150	\$1,200	\$2,300	\$2,400
Out of Pocket limit	\$5,800	\$5,950	\$11,600	\$11,900
Full contribution limit(12 months)	\$3,000	\$3,000	\$6,000	\$6,000

Age 55 or older (not in medicare) catch up HSA contributions per spouse \$1,000 in 2009 and \$1,000 in 2010.

HSA contributions by workers or employers are pre-tax and withdrawals for medical purposes are tax-free. Unused portions of the account may be rolled over to the next year. Contributions may not be made by or for an individual who is eligible for Medicare. Deductions for HSA's are entered on Form 1040 as an adjustment to income.

MSA's may be rolled over to HSA's. The Tax Relief and Health Care Act of 2006 allows a once-in-a-lifetime tax-free transfer to HSA's of the balance in Flexible Savings Accounts (FSA's) and Health Reimbursement Accounts (HRA's). The maximum transfer amount is the lesser of the balance in the account on 9/21/2006 or the balance on the date of transfer. Transfers must be made by December 31, 2012. TRHCA also authorized a one-time tax-free transfer of funds from IRA's to HSA's limited to the individuals full contribution limit for the transfer year.

COMMUTER TRANSPORTATION FRINGE BENEFITS:

Excludible limitations for employer provided transportation fringe benefits per employee for 2009 AND 2010 are \$230 per month aggregate for commuter vehicle and/or transit pass (\$120 per month before February 18, 2009), and \$230 per month for qualified parking. Cash reimbursements may also qualify for the exclusion. Beginning in 2009 employers may pay employees an excludible \$20 per month transportation fringe benefit for commuting to work on a bicycle.

SIMPLIFIED HIGH-LOW PER DIEM RATES FOR BUSINESS TRAVEL IN CONUS:

	<u>Lodgings, Meals and Incidental Expenses</u>		<u>Meals and Incidental Expenses</u>		<u>Incidental Expenses</u>
	High Cost Areas	All Other Areas	High Cost Areas	All Other Areas	All Areas
10/01/08 -					
09/30/09*	\$256	\$158	\$58	\$45	\$5
10/01/09 -					
09/30/10	\$258	\$163	\$58	\$52	\$5

* T/P may opt to use these rates through 12/31/09.

50% rules apply, however employees subject to Department of Transportation hours of service limitations may deduct 80%.

EDUCATOR EXPENSES:

The above-the-line deduction of up to \$250 for nonreimbursed classroom expenses was extended for eligible educators through 2009. Expenses must be for non-athletic supplies used by the educator in the classroom. An eligible educator is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year.

STANDARD DEDUCTIONS:

	Basic Standard Deduction 2009 (2010)	2009 Age 65 or older or blind Additional Standard Deductions			
		1	2	3	4
Single	5,700 (5,700)	7,100	8,500		
Head of Household	8,350 (8,400)	9,750	11,150		
Married Filing Joint; Qualifying Widow(er)	11,400 (11,400)	12,500	13,600	14,700	15,800
Married Filing Separate	5,700 (5,700)	6,800	7,900	9,000	10,100

Dependents: Larger of \$950 (\$950 for 2010) or earned income plus \$300 up to standard and additional standard deductions for filing status.

Age 65 or older or blind. Additional standard deduction:
 \$1,100 Married (MFJ, MFS, QW) (\$1,100 in 2010).
 \$1,400 Unmarried (S, HH) (\$1,400 in 2010)

Additional Standard Deduction for Real Property Taxes*:

The Housing Assistance Act authorized an additional standard deduction for taxpayers who do not itemize by the lesser of the amount of state and local real property taxes they paid in 2008 or \$500 (\$1,000 for married filing jointly). EESA extended this additional standard deduction through 2009.

Additional standard deduction for casualty losses*:

Non-itemizers can take an additional standard deduction for net losses from federally declared disasters for both regular tax and AMT.

Additional standard deduction for sales taxes paid on purchase of a new vehicle in 2009*.

Non-itemizers may take an additional standard deduction for certain sales taxes paid on purchase of a new vehicle in 2009.

*** NEW SCHEDULE L Standard Deduction for Certain Filers:** required of anyone who takes one or more of the new additional standard deductions listed above.

PERSONAL EXEMPTIONS:

The 2009 and 2010 exemption amount is \$3,650. Exemptions are phased out at the rate of 1% for each \$2,500 (\$1,250 MFS) or fraction thereof that AGI exceeds the following:

<u>Filing Status</u>	<u>2009 Threshold</u>
Single	\$166,800
H/H	208,500
MFJ or QW	250,200
MFS	125,100

2010 Reduction eliminated.

LIMITATION ON ITEMIZED DEDUCTIONS:

Total itemized deductions normally allowable must be reduced by:

2009 1% of AGI in excess of \$166,800 (\$83,400 MFS)

2010 Reduction eliminated.

ADOPTION TAX CREDIT (Form 8839):

Maximum non-refundable credit for adoption expenses is \$12,150 per eligible child in 2009 (\$12,170 in 2010). The credit is phased out rateably for taxpayers with modified AGI:

\$182,180 - \$222,180 for 2009
\$182,520 - \$222,520 for 2010.

The adoption credit expires after 2010.

EARNED INCOME CREDIT:

		Number of Qualifying Children			
		One	Two	Three or More	None
Earned Income amount	2009	\$ 8,950	\$12,060	\$12,550	\$5,950
	2010	\$ 8,970	\$12,590	\$12,590	\$5,980
Maximum Amt of Credit	2009	\$ 3,043	\$ 5,028	\$5,657	\$ 457
	2010	\$ 3,050	\$ 5,036	\$5,666	\$ 457
AGI Phase-out Amounts:					
Threshold	2009	\$16,450	\$16,450	\$16,450	\$7,500
Completed	2009	\$35,463	\$40,295	\$43,279	\$13,440
Threshold	2010	\$16,450	\$16,450	\$16,450	\$ 7,480
Completed	2010	\$35,535	\$40,363	\$43,352	\$13,460
Joint Returns (2009 Increase \$5,000; 2010 \$5,010):					
Theshold	2009	\$21,450	\$21,450	\$21,450	\$12,500
Completed	2009	\$40,463	\$45,295	\$48,279	\$18,440
Theshold	2010	\$21,460	\$21,460	\$21,460	\$12,490
Completed	2010	\$40,545	\$45,373	\$48,362	\$18,470

Childless low-income workers are eligible for EIC if they:

- Are age 25 through 64.
- Have a principal residence in the US for more than 1/2 of the tax year.
- Cannot be claimed as a dependent by another taxpayer.

Earned income does not include non-taxable income. Military personnel have the option (now permanent) to include non-taxable combat pay in the calculation for EIC.

Disqualified income. EIC will not be available to those who have investment income (interest, dividends, rents, royalties, capital gains, passive income) in excess of \$3,100 for 2009 (\$3,100 in 2010).

KIDDIE TAX:

For tax years beginning after May 25, 2007 the kiddie tax applies to children who are under age 19 or who are full time students under age 24. Disabled children are not excepted from the age test for the kiddie tax. The kiddie tax applies only to children whose earned income does not exceed one-half of the amount of their support. Scholarships are not counted in the support test.

For 2009, for children subject to the kiddie tax, the first \$950 is untaxed, the next \$950 is taxed at the child's rate, amounts over \$1,900 are taxed at the parent's rate. Use Form 8814 in the parent's return or Form 8615 in the child's return. Must file child's return with Form 8615 if child's investment income is \$9,500 or more. Amounts are the same for 2010.

LONG TERM CARE EXPENSES:

Long term care expenses. Unreimbursed amounts paid for qualified long term care services are treated as medical expenses. These include necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitating services, and maintenance or personal care services required by a chronically ill individual and provided pursuant to a plan of care prescribed by a licensed health care practitioner.

Long term care insurance. Qualified long-term care insurance premiums are treated as deductible health insurance premiums within prescribed limits adjusted annually for inflation:

	2009	2010
Age 40 & under	\$ 320	\$ 330
Age 41 to 50	600	620
Age 51 to 60	1,190	1,230
Age 61 to 70	3,180	3,290
Over age 70	3,980	4,110

Amounts received under a qualified long-term care contract are excludable from income. Actual expenses are fully excludable, however the exclusion amount is capped on per diem contracts at \$290.

Accelerated benefits from life insurance contracts for terminally or chronically ill persons may be treated as a death benefit and excluded from income.

CHILD TAX CREDIT:

Credit per qualifying child under age 17: \$1,000 through 2010(not indexed for inflation).

Refundable Child Tax Credit: Refundable to the extent of 15% of the taxpayers earned income in excess of a new ARRA-09 threshold of \$3,000 for 2009 and 2010. Under previous law the statutory threshold of \$10,000 would have been \$12,550 after indexing for inflation for 2009. For taxpayers with three or more children, the refundable portion is the excess of the taxpayers FICA or one-half of the self-employment tax over their earned income tax credit.

Military personnel: Military personnel have the option to include non-taxable combat pay in earned income in the calculation of child tax credit.

CHILD AND DEPENDENT CARE CREDIT (Form 2441):

Maximum Expenses		Credit	AGI Phase-down to 20%
One Child	Two or More	%	at 1% per \$2,000
\$3,000	\$6,000	35%	\$15,000 - \$43,000

ESTIMATED TAX PAYMENTS: For tax years beginning in 2009, a taxpayer who pays through withholding or timely estimated tax payments:

- 90% of the prior year’s tax is not subject to the penalty for underpayment of estimated taxes.
- Previously the requirement was 100% of the prior year’s tax or 110% for taxpayers with prior year AGI in excess of \$150,000 (\$75,000 MFS).

This provision is available only to individuals with an AGI in the prior year of less than \$500,000 (\$250,000 MFS) and if the individual certifies that at least 50% of the gross income shown on the prior year’s return was from a small trade or business with an average of not more than 500 employees during the calendar year ending in such year.

GIFT, ESTATE, AND GENERATION-SKIPPING TRANSFER TAXES:

The annual exclusion for gifts is \$13,000 for 2009.

The lifetime gift tax exclusion is fixed at \$1 million. It was not increased along with the estate tax exclusion. The gift tax was not repealed on 12/31/2009 when the estate and generation skipping transfer taxes were repealed and the gift tax rate is capped at 35%.

The maximum gift and estate tax rate was reduced to 45% in 2007. For 2009 the estate tax exclusion is \$3.5 million and the maximum estate tax credit is \$1,455,800.

The generation-skipping transfer tax exclusion amount was the same as the estate tax exclusion amount.

The estate and generation-skipping transfer taxes (not the gift tax) are repealed for decedents dying after 12/31/2009.

However, if Congress fails to act, the automatic 12/31/2010 sunset provision in EGTRRA 2001 will reinstate the gift, estate, and generation-skipping transfer taxes in 2011 under the rules in effect before May 26, 2001.

The pre-EGTRRA law provided for a unified gift and estate tax exclusion amount by 2006 of \$1 million, a unified credit of \$345,800, a maximum tax rate of 55%, a generation-skipping tax exclusion, and a 5% surtax for estates exceeding \$10 million.

State death tax credit has been repealed and replaced with a deduction for estates of decedents.

Stepped-up basis at death rules were repealed on 12/31/2009 along with the estate tax and are replaced with a modified carryover of decedent's basis rules.

EGTRRA allows executors to partially increase basis up to \$1.3 million (\$3 million in the case of a surviving spouse).

The recipient of the property will receive a basis equal to the lesser of the adjusted basis in the hands of the decedent or the fair market value of the property as of the date of the decedents death.

If, as noted above, Congress fails to extend the estate tax repeal, the rules would revert after 12/31/2010 to the pre-EGTRRA stepped-up basis rules.

GIFT AND ESTATE TAX RATES:

Column A Taxable amount over	Column B Taxable amount not over	Column C Tax on amount in Col A	Column D Rate of tax on excess over amount in Col A	
0	\$10,000	0	18%	
\$10,000	20,000	\$1,800	20%	
20,000	40,000	3,800	22%	
40,000	60,000	8,200	24%	
60,000	80,000	13,000	26%	
80,000	100,000	18,200	28%	
100,000	150,000	23,800	30%	
150,000	250,000	38,800	32%	
250,000	500,000	70,800	34%	
500,000	750,000	155,800	37%	
750,000	1,000,000	248,300	39%	
1,000,000	1,250,000	345,800	41%	(1) (5)
1,250,000	1,500,000	448,300	43%	
1,500,000	2,000,000	555,800	45%	
2,000,000	-----	780,800	45%	(2) (3) (4)

Footnotes:

- (1) Lifetime gift exclusion amount capped at \$1,000,000.
- (2) 2007: Estate exclusion amount \$2,000,000. Maximum -2008 tax credit \$780,800 Maximum tax rate 45%.
- (3) 2009: Estate exclusion amount increased to \$3,500,000. Maximum tax credit \$1,455,800.
- (4) 2010: Estate(not gift) tax repealed 12/31/09. Gift tax retained and capped at 35%. Basis at death not stepped-up to FMV. EGTRRA allows executors to partially increase basis of property up to \$1.3 million (\$3.0 million in the case of property passing to a surviving spouse).
- (5) 2011: Unless Congress acts, Pre-EGTRRA Unified Gift and Estate Tax rules are reinstated: Gift and estate exclusion amount \$1,000,000; maximum unified tax credit \$345,800; maximum tax rate 55%; basis at death stepped-up to FMV.

CALIFORNIA

FILING REQUIREMENTS FOR 2009:

Taxpayers must file if either gross income or adjusted gross income exceeds the amounts shown below:

CALIFORNIA GROSS INCOME MORE THAN:

	No Dependents	1 Dependent	2 or more Dependents
Unmarried Under 65 (S, HH, QW)	\$14,622	\$17,889	\$20,339
65 or older	19,522	21,972	23,932
Married (MFJ, MFS)			
Both spouses Under 65	29,245	32,512	34,962
One spouse 65 or older	34,145	36,595	38,555
Both spouses 65 or older	39,045	41,495	43,455

CALIFORNIA ADJUSTED GROSS INCOME MORE THAN:

	No Dependents	1 Dependent	2 or more Dependents
Unmarried Under 65 (S, HH, QW)	\$11,698	\$14,965	\$17,415
65 or older	16,598	19,048	21,008
Married (MFJ, MFS)			
Both spouses under 65	23,396	26,663	29,113
One spouse 65 or older	28,296	30,746	32,706
Both spouses 65 or older	33,196	35,646	37,606

DEPENDENT ANY AGE: Gross income or AGI more than standard deduction.

STANDARD DEDUCTIONS FOR 2009:

S or MFS	\$3,637
MFJ, HH, QW	\$7,274
Dependents	Larger of \$950 or earned income plus \$300 (not to exceed \$3,637 or \$7,274)

EXEMPTION CREDITS FOR 2009:

S, HH, MFS	\$98
MFJ, QW	\$196
Blind, age 65 or older	\$98
Dependents	\$98

TAX RATES INCREASED ACROSS THE BOARD 0.25% FOR 2009

- Maximum tax rate for individuals
taxable incomes \$1 million or less 9.55%
- Maximum tax rate for individuals
subject to mental health surcharge
taxable incomes over \$1 million 10.55%
- AMT rate for individuals 7.25%

FEDERAL/CALIFORNIA CONFORMITY/NON-CONFORMITY:

California generally conforms to the Internal Revenue Code as it read on January 1, 2005 (with many exceptions). California has generally failed to conform to any federal changes enacted in 2005 through 2009. The following are some of the many conformity issues:

Filing Status. For California, Registered Domestic Partners must file as married (either jointly or separately) for tax years beginning 1/1/2007 and later using the same rules that apply to married couples. Same-sex married couples must use the same rules as RDP's.

Pension plans. California automatically conforms to most of the federal changes in pension plans and IRA's, including:

A direct charitable contribution of up to \$100,000 from an IRA of a taxpayer over age 70½.

Allows a non-spouse beneficiary to roll over an inherited IRA into his own IRA and take distributions based on inherited IRA rules.

The direct rollover from retirement plans into Roth IRA's after December 31, 2007.

Dependents. Federal law allows a parent to forgo claiming a child as a dependent so that the child may take advantage of the education credits. California requires the parent to claim the exemption if dependency tests are met.

Divorced parents. If a divorce decree grants the dependency exemption to the non-custodial parent, for California the non-custodial parent claims the child or grants exemption to the custodial parent via IRS Form 8332 (just the reverse of Federal).

Kiddie Tax. California has not conformed to any change in age from 14. It does not conform to the age 18 rule for 2007 or to the age 19 or 24 rules for 2008 and later. Software will not solve kiddie tax problems.

Health Savings Accounts. California has not recognized HSA's, so contributions to HSA's are not deductible.

Rollovers to HSA's from MSA's, FSA's, HRA's, and IRA's are all non-qualifying distributions for California.

Earnings in an HSA are taxable in year earned.

Taxed contributions, rollovers, and earnings will create a California basis in the HSA.

Depreciation. California does not conform to bonus depreciation or to accelerated 15-year depreciation of leasehold, restaurant, and retail property. Section 179 expense is limited to \$25,000, not \$250,000 as in the federal law.

Education expenses. California does not conform to the above-the-line deductions for higher education or for educator's classroom expenses and has no education tax credits.

Itemized deductions. California itemized deductions are based on Federal itemized deductions except that state, local, and foreign income and sales taxes; California state disability insurance (CaSDI); and California lottery losses are not allowable deductions for California.

Medical expenses. Medical expenses for registered domestic partners are deductible for California purposes.

Cancellation of debt. California qualified principal residence indebtedness is limited to \$800,000 (\$400,000 for MFS) instead of the \$2 million (\$1 million MFS) federal.

California COD is limited to \$250,000 (\$125,000 MFS) vice no maximum federal.

California allows COD for 2007 and 2008 only; federal is effective through 2012.

Sale of residence. California has not conformed to the exclusion of up to \$500,000 on the sale of a principal residence by a surviving spouse who files as a single taxpayer and the sale occurs not later than two years after death of the spouse. For California the \$500,000 exclusion applies only in the year the spouse dies.

California has not conformed to federal rules on reducing the Section 121 exclusion on the sale of a principal residence for periods of nonqualified use on or after January 1, 2009.

LIMITATION ON ITEMIZED DEDUCTIONS:

For high-income taxpayers, California itemized deductions must be reduced by the lesser of 6% of the excess of Federal AGI over the threshold amounts shown below or 80% of the deductions except medical expenses, casualty & theft losses, investment expenses, and gambling losses. Threshold amounts for 2009 are:

Single, Married Filing Separate	\$160,739
Head of Household	\$241,113
Married Filing Joint, Qualified Widow(er)	\$321,483

LIMITATION ON EXEMPTION CREDITS:

EACH exemption credit is reduced, but not below zero, by \$6 (\$12 for MFJ & QW) for each \$2,500 (\$1,250 MFS) or fraction thereof that Federal AGI exceeds the same threshold amounts given above for limitation on itemized deductions.

Exemption credits may also be limited by California tentative minimum tax even when Federal AGI does not exceed the thresholds given above.

CALIFORNIA TAX CREDITS:

Joint Custody H/H Credit. 30% of net tax up to a 2009 maximum of \$387. T/P must file as single, or married filing separately and lived apart from spouse entire year, and furnish more than 1/2 of household expenses for the home, which also served as the home for T/P's child, step-child, or grandchild for at least 146 days and not more than 219 days during tax year.

Dependent Parent Credit. 30% of net tax up to a 2009 maximum of \$387. T/P must have provided over 1/2 of the expenses for a dependent parent's home, regardless of whether the parent lived with T/P. T/P must file as married filing separately and T/P's spouse can not be a member of household during last six months of tax year. Use Joint Custody Head of Household Credit worksheet to compute the credit.

Senior H/H Credit. Taxpayers 65 or over may be eligible for credit of 2% of their taxable income, up to a maximum 2009 credit of \$1,185 if: (1) they filed as H/H in 2007 or 2008, and (2) the qualifying individual died in 2007 or 2008. The credit is available only if CA AGI is not more than \$62,874 in 2009.

Renters Credit: The credit is nonrefundable and cannot be carried over. For 2009:

Single or MFS	\$ 60	Calif AGI of \$34,412 or less
All others	\$120	Calif AGI of \$68,824 or less

Refundable Child and Dependent Care Credit (Form 3506). Allows taxpayers a refundable credit for the cost of employment-related child and dependent care. The credit equals a percentage of the allowable federal child and dependent care credit based on California AGI.

Non-residents and part-year residents must use AGI from all sources, not just California AGI, to compute the credit. Qualified child and dependent care expenses are required to have occurred within California and the credit is limited to AGI from California sources.

The FTB will reject any CDC credit claim that does not contain a care provider phone number; and will call the number to verify that care was provided

Federal law requires that the taxpayer must be able to claim the qualifying individual as a dependent except in the case of divorced or legally separated taxpayers. California law permits a never-married custodial parent to claim the credit even if the custodial parent can not claim the dependent exemption for the child.

Adoption Credit. Similar to the federal but less generous. California allows a credit against regular tax of 50 percent of qualified adoption expenses up to a maximum credit of \$2,500 per child. California also excludes from income an employer's reimbursement of adoption expenses. The California adoption credit is only available if the child was in the custody of a California public agency (state, county, or city). Private adoptions or adoptions through a charitable organization do not qualify. The credit is allowed in the year the decree or order of adoption is entered, but costs for that adoption incurred in prior years may be included.

Business tax credits. Business tax credits that may be claimed against personal income and corporation franchise and income taxes are limited to 50% of a taxpayer's net tax during the 2008 and 2009 tax years. Unused credits may be carried over. A taxpayer with net business income of less than \$500,000 for the taxable year is exempt from the 50% limitation.

STATE DISABILITY INSURANCE:

	SDI rate*	Maximum Wage Base	Maximum SDI
2009	1.10%	\$90,669	\$997.36
2010	1.10%	\$90,669	\$997.36

SURCHARGE FOR HIGH INCOME TAXPAYERS:

Individuals will pay a surcharge of 1 percent on taxable incomes over \$1 million. The surcharge applies to all filing statuses, applies to estimated tax, and is not reduced by any credits.

USE TAX:

Tax to be reported includes use tax on items such as those purchased on the internet or by mail order from out-of-state retailers in cases where the seller does not collect use tax. In place of filing a separate return with BOE, the use tax line may also be used by taxpayers who are not required to hold a seller's permit or to register with the Board of Equalization.

Purchases from foreign countries. The first \$800 of personal property purchased in a foreign country by an individual from a retailer and personally hand carried into California during any 30 day period is exempt from the use tax.

Businesses with gross income of \$100,000 or more are required to register and file Use Tax Returns by April 15, 2010 to pay tax on any purchases in 2009 subject to use tax.

ALTERNATIVE MINIMUM TAX FOR 2009:

	<u>AMT Exemption</u>	<u>AMT Exemption Phaseout</u>
MFJ & QW	\$78,817	\$295,564
S & HH	\$59,114	\$221,674
MFS, trusts, estates	\$39,407	\$147,781

The AMT rate for individuals is 7.25%.

California has a minimum tax credit similar to the federal minimum tax credit.

NET OPERATING LOSSES:

California NOL's for 2008 and 2009 are suspended except for small businesses with less than \$500,000 net business income and corporate tax payers.

Year NOL										
Generated	2001	2002	2003	2004	2005	2006	2007	2008	2009	
Last Year										
Allowed	2013	2013	2013	2014	2015	2016	2017	2028	2029	

An NOL incurred prior to 2004 can only be carried forward at the reduced percentage allowed in the year incurred as follows:

Before 2000	50%
2000 & 2001	55%
2002 & 2003	60%
2004 & later	100%

For NOL's beginning January 1, 2008 and later a 20-year carryover period is allowed. Beginning in 2011 California will allow a limited 2-year carryback period.

WITHHOLDING ON REAL ESTATE SALES:

Buyers of California real estate with sales prices in excess of \$100,000 must withhold and remit to FTB 3 1/3 percent of the gross sales price.

Withholding is not required for:

- Sales of principal residences
- Sales resulting in a certifiable taxable loss
- Tax free exchanges
- Some involuntary conversions.

Withholding is also not required where the seller is:

- A tax exempt entity
- Insurance company
- IRA
- Qualified pension plan
- California corporation, partnership, or LLC
- Trust with a California trustee*
- Estate of a California decedent*

* For trusts and estates to be exempt from withholding, the property must have been the decedent's principal residence.

Election to withhold on gain. A seller of real estate may elect to have tax withheld in an amount not less than the maximum tax rate for the entity multiplied by the taxable gain.

ESTIMATED TAX PAYMENTS:

Beginning in 2009, California changes from 25% of estimated tax payment per quarter to 30% for the first two quarters and 20% for the last two quarters.

Also beginning in 2009 there is no safe harbor for individuals with AGI in excess of \$1 million (\$500,000 MFS).

For tax year 2009 and later years, individuals with an estimated tax payment or extension payment in excess of \$20,000 or with a tax liability in excess of \$80,000 in any year must remit their tax payments electronically to FTB. EFT requirement does not apply to January 15, 2009 payment for tax year 2008 estimated taxes. EFT payments can be made using FTB's Web Pay electronic fund withdrawal when e-filing or paying by credit card.

LLC FEE:

Beginning with tax year 2009, LLC's are required to make an estimated LLC fee payment by the 15th day of the sixth month of the current taxable year. A 10% underpayment penalty will be imposed if the estimated fee payment is less than the fee actually due unless the estimated fee payment equals or exceeds the fee paid by the LLC in the preceding taxable year.

TAX RETURN SIGNATURES:

Effective July 1, 2008, all CPA's, EA's, and attorneys must sign tax returns prepared by their employees unless the employee is a CPA, EA, attorney, or registered with CTEC. Tax return preparation includes data entry

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