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2010 Individual Tax Update

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Dear Client,

This is my annual tax update letter where I discuss tax law changes that are most likely to impact individual taxpayers. This update does not address tax law changes affecting businesses nor does it address the debate currently going on in Congress related to extending the Bush tax cuts.

Roth IRA Conversions: Beginning January 1, 2010, the $100,000 income eligibility limit for Roth IRA conversions was eliminated. With a Roth conversion, the amount converted (less cost basis) is taxed as regular income. The benefit of converting assets to a Roth IRA is that assets grow tax-free and eligible withdrawals are tax-free. There is an extra bonus for 2010 conversions: the taxpayer has the option of recognizing all the income in 2010 or deferring the income and recognizing 50% in 2011 and 50% in 2012.

Tax Breaks That Expired in 2010: Unless Congress acts soon, the following tax breaks expired after 2009:

- Deducting state and local sales tax in lieu of deducting state and local income tax
- Deducting up to $1,000 for property taxes in addition to the standard deduction
- Transfer of IRA funds directly to a charity
- Tax deduction of up to $4,000 for qualified higher education costs (although the American Opportunity tax credit of up to $2,500 is still allowed for 2010)
- The first $2,400 of unemployment compensation is no longer free of Federal tax.

Tax Breaks That Expired in 2011: Unless Congress acts soon, the following tax breaks expired after 2010:

- Congress is currently debating whether to extend the Bush income tax cuts which expire 12/31/10. If they don't, individual income tax rates will go up for almost all income levels, the maximum capital gains rate will increase from 15% to 20%, and tax rate qualified dividends will increase from 15% to as high as 39.6%. In addition, itemized deductions will be reduced by up to 3% for high income taxpayers, and exemptions will be phased out for high income taxpayers.
- The maximum contribution to a Coverdell education savings account will be reduced from $2,000 for 2010 to $500 for 2011.

Credit for Energy-Efficient Improvements to a Personal Residence by a Homeowner: Taxpayers receive a credit of 30% of the cost of high-efficiency home heating and air conditioning systems, water heaters and biomass stoves put in use in 2009 or 2010. The credit, which is capped at $1500, is also available for the cost of energy-efficient windows, doors and skylights. The credit is even greater for installing alternative energy equipment. The credit is 30% of the full cost of energy-efficient solar electric systems, fuel cells, solar hot water heaters,

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geothermal heat pumps and wind turbines. Homeowners can rely on the manufacturer's signed certification statement that the products qualify for the credit. *Unless extended by Congress, this credit will expire after 2010.*

For more information, go to: www.energystar.gov/index.cfm?c=tax_credits.tx_index

Plug-In Electric Vehicle Credits: A maximum Federal credit of up to $7,500 is available for the purchase of a new qualifying vehicle weighing less than 10,000 pounds. At the time of this writing, at least four vehicles have been certified for the credit: 2011 Chevrolet Volt, 2011 Nissan Leaf, 2008-2010 Tesla Roadster and the CODA sedan. Similar to the phase-out for hybrid vehicles, the plug-in credit begins to phase out for a manufacturer's vehicles when at least 200,000 vehicles manufactured by that company have been sold.

In addition to this Federal credit of up to $7,500, CA offers a rebate of up to $5,000 for certain "clean" vehicles purchased or leased on or after March 15, 2010. These rebates are offered on a first-come, first-serviced basis until the amount allotted for the Clean Vehicle Rebate Project (CVRP) runs out. The Nissan 2011 Leaf is expected to qualify for the rebate while the 2011 Chevy Volt is not.

15% Tax Rate on Qualified Dividend and Long-term Capital Gains: Qualified dividends and long-term capital gains are taxed at a maximum rate of 15% through year 2010. For taxpayers in the 10% and 15% bracket, the capital gains rate is 0%. Therefore, low-income taxpayers could have qualified dividends and long-term capital gains of up to $68,000 ($34,000 for single taxpayers) and pay no tax! Unfortunately, the "kiddie tax" rules (see next page) prevent parents from taking advantage of this break by transferring highly appreciated assets to their kids. *Unless Congress acts, the Federal rate for qualified dividends and long-term capital gains will increase to at least 20% (from the current maximum rate of 15%) effective January 1, 2011.*

COBRA Benefits: Workers who were involuntarily terminated between September 1, 2008 and May 31, 2010 qualified for a 65% subsidy of their COBRA health insurance premiums paid on or after February 17, 2009. The subsidy is available for a maximum of 15 months. High-income taxpayers who receive COBRA premium assistance will have the subsidized portion of their premium recaptured as an addition to tax on their income tax returns. "High-income" for these purposes is modified adjusted gross income of $125,000 for singles and $250,000 for those filing joint tax returns. Any premium assistance that is received by taxpayers with modified AGI more than $145,000 ($290,000 for joint tax returns) is fully captured.

IRA & Other Pension Contribution Limits: The annual amounts that can be contributed are as follows:

	2007	2008	**2009-2011**
IRA- Under Age 50	$4,000	$5,000	**$5,000**
IRA- Over Age 50	$5,000	$6,000	**$6,000**
401(k)- Under Age 50	$15,500	$15,500	**$16,500**
401(k)- Over Age 50	$20,500	$20,500	**$22,000**
SEP-IRA	$45,000	$46,000	**$49,000**

Electronic Payment of 2011 CA Estimated Payments: For 2011, certain high-income taxpayers will be required to submit their CA estimated payments electronically. The penalty for not doing so is 1% of the amount that should have been paid electronically. The CA taxpayers subject to the electronic transfer requirement are those who either made a single estimated or extension payment greater than $20,000 for any tax year after 2008 or filed a CA tax return after 2008 and owed a liability of greater than $80,000.

First-Time Home Buyer Credit: A credit of up to $8,000 for “first-time” home buyers is available to cover homes purchased November 6, 2009 through April 30, 2010 (including binding sales contracts signed by April 30, 2010 that closed by June 30, 2010). The AGI phase-out range to qualify for the credit is $125,000 to $145,000 ($225,000 to $245,000 on joint tax returns). Only homes costing $800,000 or less qualify for the credit. Even current homeowners can use this break. Those who’ve owned a home for five consecutive years out of the last eight may qualify for a tax credit of up to $6,500 if they purchased a new home during this time.

1099 Reporting for Rental Property Owners starting in 2011: The Small Business Jobs Act of 2010 requires landlords to report payments of $600 or more to each service provider during the year to the IRS on Form 1099-MISC. The due dates for providing a copy of the 2011 Form 1099s to the service provider is January 31, 2012 and to the IRS is February 28, 2012. Rental property owners not filing the Form 1099s will be subject to penalties.

To prepare the Form 1099, landlords need to obtain the name, Federal Tax Identification Number (or Social Security number) and address from all individuals and business that provide services to the rental property. IRS Form W-9 is the form to be used to obtain the required information from the service providers. It is best to have the W-9 completed by the service provider at the time you engage in his or her services, but never later than the time you make payment (or it may be difficult or impossible to obtain the needed information).

Use Tax Reporting: CA is continuing its efforts to collect use tax, which applies when sales tax was not charged. Purchases made over the internet and out-of-state are the most common type of transactions subject to use tax. The CA Legislature has enacted strict use tax registration and reporting requirements. All CA businesses with revenue of at least $100,000 must register with the CA Board of Equalization and file use tax returns for 2007 and after.

Estate Tax: For 2010 there is no estate tax. Unless Congress takes action, effective January 1, 2011, estates over $1 million will be subject to an estate tax at rate of up to 55%. On December 3, 2009, the House of Representatives, on a vote of 225 to 200, approved a bill which would set the inheritance tax at 45% permanently for estates worth over $3.5 million ($7 million for married couples). The Senate did not vote on the Bill during 2010. Hopefully Congress will address estate tax reform in 2011 so that the amount not subject to estate tax will be increased from $1 million.

Please let me know if you have any questions regarding these tax law changes.

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