Stephen P. McCarthy
CERTIFIED PUBLIC ACCOUNTANT
CERTIFIED FINANCIAL PLANNER

2009 Tax Update

December 10, 2009

Dear Client,

This is my annual tax update letter where I discuss current year tax law changes that are most likely to impact my clients.

Roth IRA Conversions: Beginning January 1, 2010, the $100,000 income eligibility limit for Roth IRA conversions will be 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.

New Deduction for Sales Taxes on New Vehicle Purchase: For vehicles purchased between February 17, 2009 and December 31, 2009, certain taxpayers can deduct, as an itemized deduction or as an addition to the standard deduction, sales taxes on the purchase of a qualifying vehicle. Qualifying vehicles, which must be purchased new, include a passenger auto, light truck, or motorcycle with a gross vehicle weight rating of not more than 8500 pounds, or a motor home. Only $49,500 of the purchase price qualifies for deduction. Unlike other taxes, the sales tax deduction is allowed even if the taxpayer is subject to alternative minimum tax. The deduction is phased out if the taxpayer’s modified adjusted gross income (AGI) is between $125,000 - $135,000 for singles and $250,000 - $260,000 for those filing joint returns.

First-Time Home Buyer Credit Extended and Enhanced: A credit of up to $8,000 for “first-time” home buyers was extended to cover homes purchased November 6, 2009 through April 30 2010 (including binding sales contracts signed by April 30, 2010 that close by June 30, 2010). The AGI phase-out range to qualify for the credit has been increased to $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 purchase a new home. Buyers who purchase in 2009 can claim the credit on their 2008 tax return and buyers who purchase in 2010 can claim the credit on their 2009 tax return.

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 storm windows, storm 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, geothermal heat pumps and wind turbines. Homeowners can rely on the manufacturer’s signed certification statement that the products qualify for the credit.

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

Three Lagoon Dr., Suite 155, Redwood Shores, CA 94065
(650) 610-9540 e-mail: steve@mamportfolios.com

Qualified Alternative Fuel Motor Vehicle Credit: In addition to existing tax credits for hybrids, alternative fuel vehicles, qualified fuel cell and advanced lean burn technology, a new credit of up to $4,000 was added in 2009 for the cost of converting any motor vehicle into a qualified plug-in electric drive motor vehicle. The popular hybrid vehicle credit, though, is limited to the first 60,000 qualifying vehicles sold by each manufacturer. The hybrid credit for Toyota and Honda vehicles was phased out prior to 2009, and Ford vehicles started to be phased out for purchases on or after April 1, 2009.

The 2009 Recovery Act created a new 10% credit for electric drive low-speed vehicles, motorcycles, and three-wheeled vehicles. The maximum credit is $2,500 and it is available for purchases through December 31, 2011. Street-legal electronic golf carts qualify for an especially generous credit. Typical credits range between $4,000 and $6,000 for vehicles that have IRS approval. These neighborhood electric vehicles get a base credit of $2,500 plus an extra amount depending on the capacity of the battery. In some cases, the tax credit available may be more than half of the vehicle's cost.

Making Work Pay Credit: The American Recovery and Reinvestment Act of 2009 included a "worker tax credit' of $400 for working individuals and $800 for families for 2009 and 2010. This credit is calculated at a rate of 6.2% of earned income and phases out for taxpayers with adjusted gross income in excess of $75,000 for individuals and $150,000 for couples filing jointly. Workers started to receive the credit last April through a reduction in their Federal tax withholding from their paychecks. *But the new tax withholding tables issued by the IRS caused millions of taxpayers to have their withholding reduced more than they are entitled to under the new law.* Workers not qualifying for the credit will need to repay the credit on their 2009 and 2010 Federal returns.

The basic problem is that the withholding tables cannot factor in income other than the employee's wages from that employer when determining whether there should be a reduction in withholding. At-risk taxpayers include married couples in which both spouses work, workers with more than one job, retirees who have federal income taxes withheld from their pension payments and Social Security recipients with jobs that provide taxable income.

15% Tax Rate on Qualified Dividend and Long-term Capital Gains: Under current law, qualified dividends and long-term capital gains are taxed at a maximum rate of 15% through year 2010. For years 2008 through 2010, taxpayers in the 10% and 15% bracket have a 0% capital gains rate. Therefore, low-income taxpayers could have qualified dividends and long-term capital gains of up to $67,900 ($33,950 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. *I expect that Federal rate for qualified dividends and long-term capital gains will increase to at least 20% (from the current maximum rate of 15%) by no later than 2011.*

Educational Tax Credit: Prior tax law contained tax credits for higher education costs called the Hope Credit and Lifetime Learning Credit. While the Lifetime Learning Credit remains the same, the Hope Credit was renamed and enhanced. The new name is the American Opportunity Tax Credit. It now covers the first four years of college (up from two years previously), is a maximum credit of $2,500, now includes the cost of computers, and has a higher AGI phase out range of $160,000 to $180,000 ($80,000 to $90,000 for single taxpayers).

COBRA Benefits: Workers who are involuntarily terminated between September 1, 2008 and December 31, 2009 qualify 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 nine 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 amount that can be contributed is as follows:

	2006	2007	2008	**2009-2010**
IRA- Under Age 50	$4,000	$4,000	$5,000	**$5,000**
IRA- Over Age 50	$5,000	$5,000	$6,000	**$6,000**
401(k)- Under Age 50	$15,000	$15,500	$15,500	**$16,500**
401(k)- Over Age 50	$20,000	$20,500	$20,500	**$22,000**
SEP-IRA	$44,000	$45,000	$46,000	**$49,000**

Transfer of IRA Funds Directly to a Charity: Originally scheduled for 2006 and 2007 only, this provision was extended through 2009. It allows an IRA owner, age 70 ½ or over, to directly transfer tax-free up to $100,000 per year to an eligible charitable organization(s). This provides an exclusion from gross income for otherwise taxable IRA distributions (although an itemized deduction cannot be claimed for the contribution). These charitable distributions are treated as distributions for required minimum distribution (RMD) purposes. Since the IRA distribution is not included in AGI, the Medicare premium surcharge may be reduced or fewer Social Security benefits may be taxable.

2009 CA Tax Increases: As part of last summer's California Legislature budget agreement, the following individual tax increases were voted in retroactively for 2009:

- A 0.25% increase in individual tax rates across the board (i.e. the 1.00% bracket was increased to 1.25%, 2.00% bracket increased to 2.25%, etc.)
- A reduction of the dependent exemption by $211 per dependent
- A 0.25% increase in the alternative minimum tax rate (from 7.00% to 7.25%)

2010 CA Estimated Payments: In a short-sighted effort to balance the budget for the fiscal year ending June 30th, 2010, the CA Legislature accelerated the required 2010 estimated payments for individuals and corporations. The percent of the "required annual payment" is 30% due for the 1st quarter, 40% due for the second quarter, 0% due for the third quarter, and 30% due for the 4th quarter.

Use Tax Reporting: After years of having little success in collecting use tax from CA residents, the CA Legislature enacted strict new use tax registration and reporting requirements. Use tax applies when sales tax has not been charged. Purchases made over the internet and out-of-state are the most common type of transactions subject to use tax. All CA businesses with revenue of at least $100,000 must now register with the CA Board of Equalization and file use tax returns for 2007, 2008 and 2009.

Estate Tax Reform: For 2009, estates of up to $3.5 million are exempt from estate tax. Based on current law, the estate tax is set to expire next month and disappear for one year. It then returns in 2011 at a 55% tax rate with a $1 million exemption. On December 3, 2009, the House of Representatives, on a vote of 225 to 200, approved a bill which effective January 1, 2010 would set the inheritance tax at 45% permanently for estates worth over $3.5 million. The exemption for married couples would be $7 million. The Senate still needs to vote on the Bill.

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

Steve McCarthy, CPA, CFP