

OVERVIEW

FOCUS OF OUTLINE

This outline focuses on Federal tax law for Individuals.

We will presume you prepared tax returns for Year 2007 and are familiar with basic tax laws and forms as of 2007. This is not a review of all tax law, but an update on the new and the difficult. The intent is to help you get off to a running start on the 2008 tax-filing season. NEW LAW is covered with enough detail to get you through the coming filing season. Difficult new areas and changes for 2009 and on may not be covered thoroughly. We want to get ready for the coming season, not necessarily for the tough planning cases we encounter.

Thirteen significant tax laws have been law in the past 2 years: The Worker, Retiree and Employer Recovery Act of 2008, the Emergency Economic Stabilization legislation (containing the Emergency Economic Stabilization Act, the Energy Improvement & Extension Act, and the Tax Extenders & AMT Relief Act), the 2008 Student Health Insurance Act, the Fostering Connections To Success & Increasing Adoptions Act of 2008, the Housing Assistance Tax Act of 2008, the Heroes Earnings Assistance & Relief Act of 2008, the Food, Conservation & Energy Act of 2008, the Heartland, Habitat, Harvest & Horticulture Act of 2008, the Economic Stimulus Tax Act of 2008, the Mortgage Forgiveness Relief Act of 2007 and the Small Business & Work Opportunity Tax Act of 2007. California has not yet conformed to any of these acts, although partial conformity to certain provisions is mandatory.

HANDBOOK FOR TAX SEASON

The authors offer this as a practical handbook to help guide you through the filing season. Any changes or additions to this outline after the revision date shown below will be posted at our website—www.brasstax.com.

ORDER OF OUTLINE

The outline is ordered similarly to Form 1040 and its lettered schedules and numbered forms. Thus mortgage interest is dealt with under “Schedule A”, depreciation rules under “Form 4562”, and so on.

THE FORMS THEMSELVES

FEDERAL FORM 1040:**CHANGED LINES CONTENT.**

LINE 39 is where the Standard Deduction is calculated. There is a new checkbox to indicate the Standard Deduction includes real estate taxes or disaster losses. See page 108 for discussion on real estate taxes, and page 149 for discussion on disaster losses.

LINES 47-55 (TAX CREDITS) are rearranged. The line for Residential Energy Credit has been removed—it is now a checkbox on Line 53.

LINES 56 THROUGH 59 used to be Lines 57 through Line 60.

LINE 61 THROUGH 67 used to be Lines 63 through 69.

LINE 68 (formerly Line 70) has an additional checkbox for the AMT Credit from Form 8801.

NEW LINE 69 is for the First-Time Homebuyer Credit, and requires Form 5405. See discussion at page 162.

NEW LINE 70 is for the Recovery Rebate Credit – see discussion starting on page 102.

LINE 71 (FORMERLY LINE 72) is total payments.

REMAINING LINES are renumbered. The final Form has one line less than in 2007.

FORM 1040A & FORM 1040-EZ. Each of these has added a Line for the Recovery Rebate Credit – other than this there are no changes to either Form. The 1040A has a provision for the addition to the Standard Deduction for real estate taxes, but the 1040-EZ does not. The “look” of the Forms is unchanged.



2008 & ON – CALIFORNIA SAME-SEX COUPLES

SAME-SEX MARRIED COUPLES (SSMCs) FILE 540s AS IF A MARRIED COUPLE. California requires Same-Sex Married Couples to file as a married couple for 2008 and on.

LEGAL HISTORY IN CALIFORNIA. On 05-15-2008, the California Supreme Court invalidated two provisions of the Family Code that had prevented same-sex couples from getting married (*In re Marriage Cases* (2008) 43 Cal. 4th 757). Under the court's decision, same-sex couples were allowed to marry beginning at 5:00pm on Monday, June 16, 2008. On June 20, 2008, FTB issued Notice 2008-5 that advised SSMC of their obligations resulting from this court case.

Proposition 8, addressing same-sex marriages, appeared on the November 4 California ballot. The initiative passed and is effective the day after the general election. The passage overturns the current law established by the California Supreme Court in the above decision. The California constitution now states that only marriage between a man and a woman is valid or recognized in California. However, the current California Attorney General has declared that same-sex marriages that occurred from June 16, 2008 through November 4, 2008 will be deemed to be valid until or unless the courts deem otherwise.

DETAILS. FTB Publication 776, "Tax Information For Same-Sex Married Couples" is a necessary aid for us. A "California SSMC Adjustments Worksheet—Recalculated Federal Adjusted Gross Income" helps us compute the differences in income, adjustments and expenses for California return versus Federal return. It is similar to the worksheet used by RDPs.

COMMUNITY PROPERTY RULES apply as explained for RDPs.

COMBINED FEDERAL AGI (with modifications) applies for California purposes as explained for RDPs.

PREPARING THE RETURNS can be a challenge, but will be similar to the RDP returns discussed on the previous page.

DEPENDENCY

2 TIERS OF DEPENDENCY (Began In 2005)	
A. Tier 1 Dependent: Also called “Qualifying Child”	
Residency Test	Dependent must have same principal residence as taxpayer for more than ½ the year. “Temporary absence” for illness, education, incarceration, business, vacation, or military service is ignored. A dependent who is born or dies during tax year qualifies, except a stillborn child. Dependent Child must be US citizen, US national or resident alien of Canada, Mexico, or the US. Dependent needs a valid SSN, ITIN, or ATIN.
Relationship Test	Dependent must be <ul style="list-style-type: none"> • T/P’s child, stepchild, sibling, stepsibling, or a descendent of one of these. • Legally adopted. • A foster child (placed by authorized agency or order of a competent court) who was a member of the household for the entire year.
Age Test	Must be under 19 (24 if a full-time student). No age limitation if the individual is totally and permanently disabled. NOTE: Different age requirements apply for the Child Tax Credit (age 17) and the Dependent Care Credit (age 13). After 2008 – Dependent must be either (a) younger than claimant, or (b) permanently & totally disabled. (Increasing Adoption Act of 2008)
General Notes	<p>SELF-SUPPORTING CHILD. A child who provides more than half his/her own support is not a qualifying child for dependency purposes, but might be a qualifying child for purposes of the EIC.</p> <p>NOT A DEPENDENT. One who can be claimed as another’s Tier 1 Dependent may not claim any dependents on his/her own return.</p> <p>TIE-BREAKER RULES. If a child is Tier 1 for multiple T/Ps we have 2 levels of rules:</p> <ol style="list-style-type: none"> 1) After 2008 – Where both a parent and a non-parent qualify to claim a Tier 1 dependent, the non-parent may NOT claim the dependency unless non-parent has higher AGI than parent. (Increasing Adoption Act of 2008) 2) If a Tier 1 dependent is <u>claimed by both T/Ps</u>, apply the following rules in order. <ul style="list-style-type: none"> • PARENT FIRST. If one of the individuals is parent of the child, parent wins. • BOTH PARENTS – NO JOINT RETURN. If both parents claim, but do not file a joint return, parent with whom the child lived for the greater part of the year wins. • NONE IS PARENT – HIGHEST AGI. If no claiming individual is the parent, the child is the qualifying child of the claimant with highest AGI. <p>DIVORCE/SEPARATION. Dependency goes first to parent with whom a child lives for greater portion of the year. Dependency may be waived, and must be waived where certain decrees of divorce/separation award dependency to non-custodial parent.</p> <p>JOINT RETURN. After 2008 – a person filing a joint return (except for refund only) cannot be a Tier 1 dependent of another. (Increasing Adoption Act of 2008)</p> <p>KIDNAPPED CHILD. If an otherwise “qualifying child” is presumed by law enforcement authorities to have been kidnapped by someone who is not a member of the family, the child is deemed to be a “qualifying child” for all purposes of the Tax Code. This ends the year after the child is determined to be dead, or would have turned 18.</p>
B. Tier 2 Dependent: Also called “Qualifying Relative”	
5 Tests	<p>The original 5 tests from before the law change continue to apply</p> <ol style="list-style-type: none"> 1. Citizen or Resident Test 2. Joint Return Test 3. Support Test 4. Member of Household or Relationship Test 5. Gross Income Test <p>NOT A TIER 1 DEPENDENT OF ANOTHER TAXPAYER. We may not claim as a Tier 2 Dependent anyone who qualifies as a Tier 1 Dependent of another person. EXCEPTION: You may claim a Tier 2 dependent if the person who could claim the dependent under Tier 1 (a) is not required to file a return, and does not file a return, or (b) files a return simply to claim a refund of <i>withheld</i> taxes. (IRS Notice 2008-5)</p>

INTERACTION OF DEPENDENCY RULES
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Here's an expanded view of the rules for Tier 2 Dependency:

5 TESTS OF DEPENDENCY—Tier 2 Dependent—“QUALIFIED RELATIVE”	
A. A Potential Dependent Must Pass All Five Of These Tests	
Citizen or Residency Test	Must be U.S. citizen, national or a resident of the U.S., Canada or Mexico.
Joint Return Test	Must be unmarried, or, if married, must not file a joint return, except for refund.
Support Test	Taxpayer must provide over 50% of potential dependent's support.
Member Of Household Or Relationship Test	<p>TIER 2A: Must be the taxpayer's:</p> <ul style="list-style-type: none"> • Child, stepchild, foster child or a descendent of any of them; • Brother, sister, niece or nephew; • Father, mother, grandmother, grandfather, aunt or uncle; • Step-brother, step-sister, step-father, step-mother or any of the following in-laws—son, daughter, father, mother, brother or sister. <p>OR</p> <p>TIER 2B: A person (related or not) who lived with T/P all year as member of T/P's household, as long as the relationship does not violate local law.</p>
Gross Inc. Test	Must have gross taxable income of less than \$3,500 in 2008.
B. And Watch Out For This!	
Caveat	<p>NOT A TIER 1 DEPENDENT OF ANOTHER TAXPAYER. We may not claim as a Tier 2 Dependent anyone who qualifies as a Tier 1 Dependent of another person.</p> <p>EXCEPTION: You may claim a Tier 2 dependent if the person who could claim the dependent under Tier 1 (a) is not required to file a return, and does not file a return, or (b) files a return simply to claim refund of <i>withheld</i> taxes. (IRS Notice 2008-5)</p>

SEPARATED PARENTS

CUSTODIAL PARENT WINS! Here's a chart of key tax issues:

Item	Custodial Parent may benefit from	Non-custodial Parent may benefit from
Dependency Exemption	●	
Head of Household Status	●	
Child/Dependent Care Exp and excludable employer-paid dependent care assistance	● ¹	(1)
Earned Income Credit	● ²	
Tuition Deduction	● ³	
Education Credits	● ³	
Child Tax Credit	●	
Additional Child Tax Credit	● ²	
Medical Expenses of Child		● ⁴

- (1) Custodial parent may claim his/her own expenses and can't use non-custodial parent's expenses. Non-custodial parent may not claim at all.
- (2) Denotes a refundable credit – has value even if tax is low.
- (3) Expense is claimed on return where personal exemption is claimed, regardless of who paid the money.
- (4) Each parent may claim his/her own expense.

FORM 8332 – WAIVER OF EXEMPTION. Custodial spouse may sign the waiver form, passing the personal exemption to non-custodial spouse as long as:

- child is in the custody of one or both parents for more than half the year,
- child receives more than half support from one or both parents, and
- parents are legally divorced or separated, or live apart the last 6 months of the tax year.

FEDERAL EXCEPTION ONLY – DECREE SPECIFIES. If the above are true, but the decree specifically awards the dependency to the non-custodial spouse, the waiver need not be used (valid 2005 through 2008 only).

How does the waiver affect tax benefits? Turn the page.

FILING STATUS – HEAD OF HOUSEHOLD
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REQUIREMENTS SUMMARIZED in the chart below.

You May File As Head of Household If:	
You are Unmarried or “Considered Unmarried”, and you	<p>“CONSIDERED UNMARRIED” – You may be legally married but still considered to be unmarried solely for purposes of using this filing status if you meet ALL OF THE FOLLOWING:</p> <ul style="list-style-type: none"> • File a separate return • Pay more than half the cost of maintaining your household • Lived apart from spouse during last 6 months of the year, where spouse’s “temporary absence” (below) counts as time living with you
Have a DEPENDENT (either Tier 1 or Tier 2) who:	<ul style="list-style-type: none"> • Is related to you more closely than cousin (this removes the unrelated Tier 2B Dependent from consideration), and • Claims your household as his/her main home for more than half the year, and you pay more than half the cost of maintaining the home. <p>NOTES/EXCEPTIONS:</p> <ol style="list-style-type: none"> 1) A dependent parent need not live with you if you pay more than half the cost of maintaining their household, which can include a rest home or nursing facility. 2) “Temporary Absence.” You and your qualifying person are considered to be living together if one (or both) of you are temporarily absent from your home due to special circumstances, including illness, education, business, vacation, military service, or incarceration. It must be reasonable to assume the absent party will return to your home after the absence, and you must continue to provide more than half its cost during the absence. 3) Waiving of the dependency to the other parent via Form 8332 does not waive the ability to claim Head of Household status.

THAT’S IT – NO OTHER RULES OR EXCEPTIONS! We know this may look too short or too simple when compared to the rambling rules and tables in IRS publications. Nonetheless, the chart above is accurate and complete.

LINE 15, 16 & 20 – PENSIONS

SOCIAL SECURITY



SOCIAL SECURITY EARNINGS LIMITS

I am still working and want to receive Social Security. What are my earnings limit before I lose some of my Social Security?

- 1) EARNINGS LIMIT AT RETIREMENT AGE—NONE.
- 2) EARNINGS LIMIT PRIOR TO RETIREMENT AGE. The maximum annual earnings level for Social Security recipients aged below full retirement age is:

Year 2009	\$14,160 (\$1,180/Mo)
Year 2008	\$13,560 (\$1,130/Mo)
Year 2007	\$12,960 (\$1,080/Mo)
Year 2006	\$12,480 (\$1,040/Mo)
Year 2005	\$12,000 (\$1,000/Mo)

Taxpayer forfeits \$1 of Social Security for each \$2 of earnings above the cap.

- 3) PERSONS REACHING RETIREMENT AGE DURING THE YEAR: The maximum *monthly* earnings level for Social Security recipients prior to the month in which they reach full retirement age during the year is:

Year 2009	\$3,140/Mo (\$37,680 Annual)
Year 2008	\$3,010/Mo (\$36,120 Annual)
Year 2007	\$2,870/Mo (\$34,440 Annual)
Year 2006	\$2,770/Mo (\$33,240 Annual)
Year 2005	\$2,650/Mo (\$31,800 Annual)

Taxpayer forfeits \$1 of Social Security for each \$3 of earnings above the cap in those months prior to reaching retirement age. This applies only to earnings for months prior to retirement age. Upon reaching retirement age, there is no limit.

DELAYED RETIREMENT CREDIT: A retired worker, beginning with the month in which he/she reaches full retirement age and ending with the month prior to attainment of age 70, may earn a delayed retirement credit for any month for which the retired worker requests that benefits not be paid even though he/she is already on the benefit rolls.

RETIREMENT PLAN MANDATORY DISTRIBUTION ISSUES

TWO CASES require retirement plan distributions to become mandatory:

- A. AGE 70½.** When a person reaches the required beginning date (RBD), or
- B. INHERITED.** After an owner of a retirement plan dies.

EXCEPTION FOR 2009 ONLY. The Worker, Retiree & Employer Recovery Act of 2008 suspends the RMD rules for 2009 for both of these two cases.

TWO SETS OF RULES. We will cover each of these rules.

NOTE: MEANING OF "RBD" is a distribution is required *each year* beginning with the year you reach 70½. An exception applies to the *very first* distribution – it may be taken as late as April 1 of the year *following* the year one reaches age 70½. This date is named "required beginning date" (RBD).

HOW TO SPOT THE DIFFERENCE

WHO OWNS THIS IRA? Look at the titling of the IRA. You need to see an account statement. Are *two names* or *three names* in the titling?

- **ALIVE – 2 NAMES.** I am still alive. My IRA title reads: "*Capital Bank & Trust, Trustee of the Traditional IRA of Michael P. Karll.*"
First name – custodian – Capital Bank & Trust.
Second name – Account "owner" – your client – the client is *alive*.
- **DEAD – 3 NAMES.** If I die and leave the IRA to David, title now reads: "*Capital Bank & Trust, Trustee of the Traditional IRA of Michael P. Karll, Deceased; For the benefit of David L Gorsich, Beneficiary.*"
First name – custodian – Capital Bank & Trust.
Second name – decedent – Michael Paul Karll.
Third name – your client – inheritor – beneficiary – David L. Gorsich.
If your client's name is third in line, the account is an inherited account!

ONE OF THREE TABLES is used in any minimum distribution calculation.

LIVING ACCOUNT OWNER. If the taxpayer owns the IRA use the table on page 36. (A distribution is required even in the year of death!) A few folks use another table - we discuss this special case on page 35.

INHERITOR OF ANOTHER'S ACCOUNT. The third table, on page 40, is used by taxpayers for minimum distributions from a decedent's IRA.

Education Savings Account VS Qualified Tuition Plans—2008

Item	Education Svgs Acct (§530)	QTP (§529) Plan
Eligibility and Maximum contributions allowed	Any contributor (including a minor) can set up an account for any beneficiary (under age 18), but the maximum contribution is \$2,000 per beneficiary per year (from all contributors). For elementary, secondary, undergraduate or graduate level education.	Any contributor (other than a minor) can set up an account for any beneficiary. Maximum contribution per beneficiary is determined by cost of tuition for a 4-year school in state (>\$100K). Only for undergraduate or graduate level education.
Deduction?	No	No
Date to make contributions	By following April 15.	By end of calendar year.
Contribution Allowance phased out	Yes, Joint = \$190,000-220,000 All Others = \$95,000-110,000	No. Contributions allowed without regard to income.
Gift tax problems	None	Contribution is completed gift eligible for \$12,000/year exclusion. Special 5-yr averaging available for gifts over \$12,000. Rollovers and change of beneficiaries subject to gift tax.
Penalties for early withdrawal	10% of taxable distribution for the excise tax Plus Regular income tax on taxable distribution	10% of taxable distribution Plus Regular income tax on taxable distribution No penalty if used for qualified education expenses, if death or disability of beneficiary or to extent of scholarship received.
Age to withdraw	Within 30 days after beneficiary turns 30	No age limitation (Calif =Must be withdrawn by age 45)
Is withdrawal taxable?	No tax on principal or income if used for qualified education expenses, or death or disability. Taxable if not used for qualified education expenses after basis is recovered pro-rata.	No tax on principal or income if used for qualified education expenses. Taxable if not used for qualified education expense by whoever receives money. Basis is recovered pro-rata.
Rollover or transfer allowed?	Yes—to another ESA for benefit of old beneficiary or for benefit of another member of the same family.	Yes—to another QTP for benefit of old beneficiary or for benefit of another member of the same family as old beneficiary.
Coordination with other benefits or plans	Contribution allowed if contribution in same year to QTP. No HOPE or Lifetime Learning education credit for expenses paid with tax-free monies taken from ESA.	Contribution allowed if contribution in same year to QTP. No HOPE or Lifetime Learning education credit for expenses paid with tax-free monies taken from QTP.

**LINE 23
EDUCATOR EXPENSE
DEDUCTION**



DEDUCTION EXTENDED FOR 2008 & 2009

This provision was due to end on 12-31-2007, but is extended for 2008 & 2009.
Tax Extenders & AMT Relief Act of 2008.

WHICH EXPENSES? Under IRC 62(a)(2)(D), eligible educators may claim an above-the-line deduction for up to \$250 of unreimbursed qualified expenses for items such as books, supplies, computer equipment (including related software and services) and other equipment and supplementary material used in their classroom. To be eligible for this deduction, the expenses must be otherwise deductible under IRC 162 as a trade or business expense.

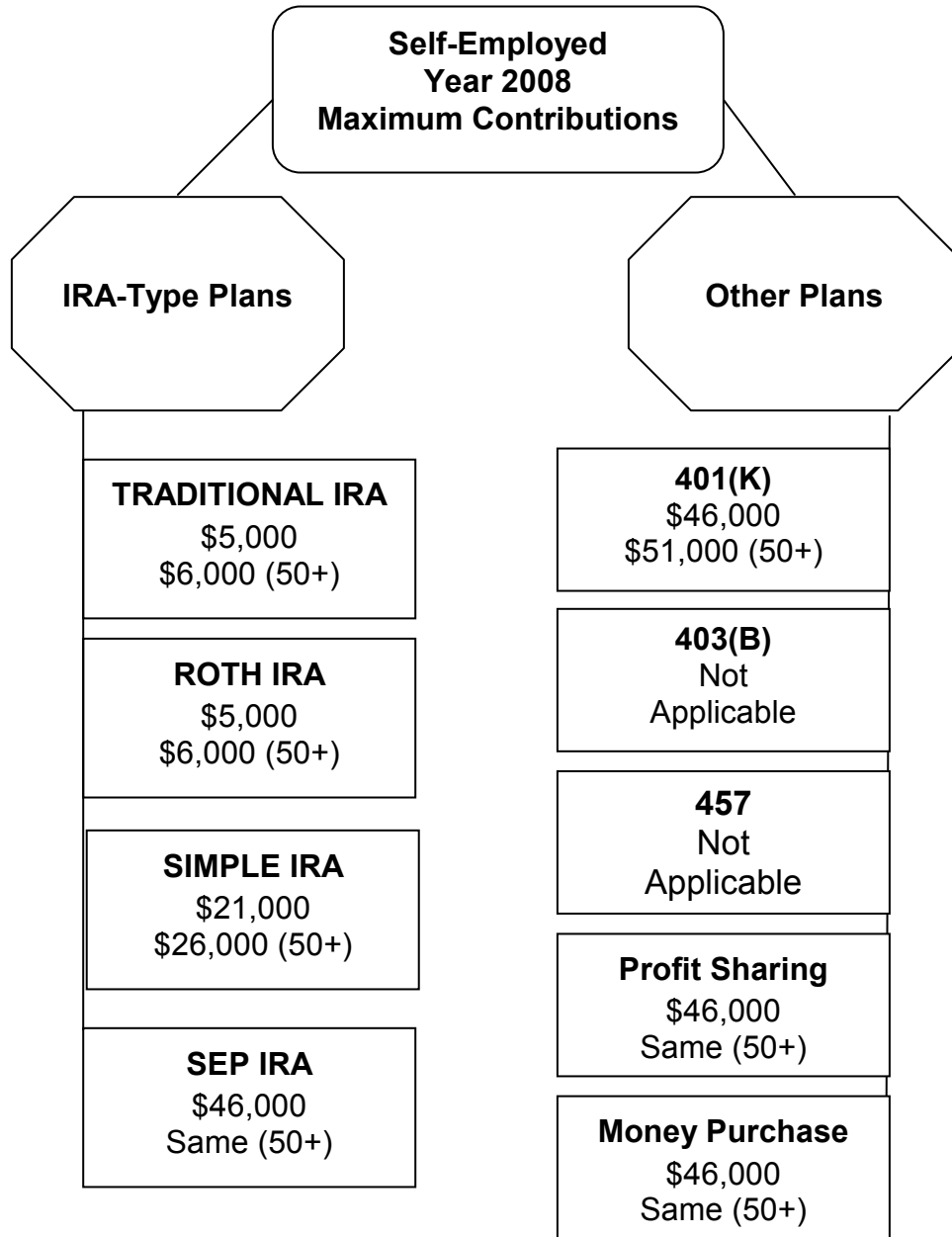
WHO IS AN “ELIGIBLE EDUCATOR”? Teachers, instructors, counselors, principals or aides who work at least 900 hours during a school year in a school providing elementary or secondary education, as determined by state law, are “eligible educators.” The school may be a public, private or religious institution.

OFFSETS FOR OTHER BENEFITS. This deduction is allowed to the extent the eligible expenses exceed, for the calendar, the amount excludable by the educator under: 1) the exclusion of savings bond income by a person who pays qualified higher education expenses (IRC 135); 2) qualified tuition program exclusion (IRC 529(c)(1)); and 3) payout from a Coverdell education savings account for qualified education expenses (IRC 530(d)(2)).



CALIFORNIA DIFFERENCES

California does not conform to this Federal provision.



PRACTICE NOTE – USING THESE CHARTS

3-PAGE UNIT. This page and the next 2 show the maximum amount a self-employed person can contribute to a pension. This page is for 2008 only. The next shows how the amounts are scheduled to change through 2009.

THIRD PAGE – ACTUAL CONTRIBUTION MAXIMUM. This page shows how a particular client’s personal maximum may be limited by compensation.

NOTE: EMPLOYEES use the charts beginning on Page 26.

I AM SELF-EMPLOYED

WHAT IS THE ANNUAL MAXIMUM AMOUNT
I CAN PUT IN MY RETIREMENT PLAN?

Plan	2007	2008	2009
SIMPLE IRA			
Under Age 50	Double Employee \$21,000	Double Employee \$21,000	Double Employee \$23,000
Age 50 & Over	Double Employee \$26,000	Double Employee \$26,000	Double Employee \$28,000
SEP IRA	\$45,000	\$46,000	\$49,000
1-Person 401(k)			
Under Age 50	\$45,000	\$46,000	\$49,000
Age 50 & Over	> Age 50 + \$5,000 \$50,000 Max	> Age 50 + \$5,000 \$51,000 Max	> Age 50 + \$5,500 \$54,500 Max
403(b)—TSA			
Under Age 50	Not Applicable	Not Applicable	Not Applicable
Age 50 & Over	Not Applicable	Not Applicable	Not Applicable
457—Def Comp			
Under Age 50	Not Applicable	Not Applicable	Not Applicable
Age 50 & Over	Not Applicable	Not Applicable	Not Applicable
Profit Sharing Keogh	\$45,000	\$46,000	\$49,000
Money Purchase Keogh	\$45,000	\$46,000	\$49,000
Def Benefit Keogh	No Maximum	No Maximum	No Maximum

NOTE: EMPLOYEES use the charts beginning on Page 26.

SPECIAL NOTE: MAXIMUM APPLIES TO ALL PLANS COMBINED. Some clients will have retirement plans at two or more jobs, or may be wage earners and self-employed at the same time. For example, a worker covered under both a SIMPLE and a profit sharing plan may not contribute more than \$10,500 to the SIMPLE, but has a maximum of \$46,000 for the profit sharing plan – if this client already funded \$10,500 to the SIMPLE, the maximum allowable for the profit sharing plan in the same year is reduced to \$35,500.

IRA CONTRIBS & DEDUCTIONS

TRADITIONAL IRA—NOT ACTIVE PARTICIPANT. You can contribute to a traditional IRA if you have earned income and are under age 70 ½. If you, and your spouse if married, are not an “active participant” in any qualified plan, the amount you either contribute to a traditional IRA is the amount you deduct.

TRADITIONAL IRA—ACTIVE PARTICIPANT. If you, or your spouse, are an active participant, the deduction could be eliminated or limited if AGI is too high. Deduction of a traditional IRA phases out at the amounts shown for the active participant. The phase out range for MFS filing status is \$0-\$10K.

MY SPOUSE IS AN ACTIVE PARTICIPANT, BUT I AM NOT. An individual is not treated as an active participant in an employer-sponsored plan merely because the individual’s spouse is an active participant.

	Active Participant		Non-Active Participant
Tax Years	Single Returns	Joint Returns	Joint Returns
2002	\$34,000 to \$44,000	\$54,000 to \$64,000	\$150,000 to \$160,000
2003	\$40,000 to \$50,000	\$60,000 to \$70,000	\$150,000 to \$160,000
2004	\$45,000 to \$55,000	\$65,000 to \$75,000	\$150,000 to \$160,000
2005	\$50,000 to \$60,000	\$70,000 to \$80,000	\$150,000 to \$160,000
2006	\$50,000 to \$60,000	\$75,000 to \$85,000	\$150,000 to \$160,000
2007	\$52,000 to \$62,000	\$83,000 to \$103,000	\$156,000 to \$166,000
2008	\$53,000 to \$63,000	\$85,000 to \$105,000	\$159,000 to \$169,000
2009	\$55,000 to \$65,000	\$89,000 to \$109,000	\$166,000 to \$176,000

IRA CONTRIBUTION LIMITS. Maximum allowable contributions to a traditional and/or a Roth IRA are shown below. Contributions can be made 100% to either type of IRA or some to both of them, but the total cannot exceed this amount.

For Tax Years	Under Age 50	Age 50 & Above
2008 & Later	\$5,000	\$6,000
2006-2007	\$4,000	\$5,000
2005	\$4,000	\$4,500
2002-2004	\$3,000	\$3,500

SCHEDULE A



AGAIN FOR 2008 – DEDUCTION PHASE-OUT REDUCED

Part of the 2001 Tax Act started in 2006. The normal formula for reduction of itemized deductions involves:

STEP 1: Find the amount by which AGI exceeds the phase out number:

STEP 2: Reduce itemized deductions by 3% of the excess found in step 1, HOWEVER, the following itemized deductions are NOT reduced:
 Medical, Investment Interest, Casualty Losses, Gambling Losses,
 AND, itemized deductions cannot be reduced by more than 80%, or below the standard deduction.

STEP 3: **NEW FOR 2006 – 2009.**

IN 2006, 2007 the reduction is 2/3 of the amount calculated in Step 2.

IN 2008, 2009 the reduction is 1/3 of the amount calculated in Step 2.

IN 2010 AND ON, the reduction returns to the familiar form.

MEDICAL DEDUCTIONS



NEW MEDICAL MILEAGE AMOUNTS FOR 2008

For 2008 returns, use 19¢ per mile (Jan 1 through June 30) and 27¢ per mile (July 1 through December 31) for the standard medical mileage allowance. In 2007, we used 20¢. For 2009, the amount is 24¢ per mile.

Revenue Procedure 2007-70 and 2008-72.

MEDICARE B PREMIUMS are deductible as a medical expense. The amounts are:

	2007	2008	2009
Base Monthly Premium	\$93.50	\$96.40	\$96.40
Yearly Total	\$1,122.00	\$1,156.80	\$1,156.80

TAX DEDUCTIONS

**EXTENDED FOR 2008 & 2009 – SALES TAX DEDUCTION**

EXTENDED. This provision was due to end on 12-31-2007, but is extended for 2008 & 2009.

MAKE AN ELECTION. On Schedule A you may choose to deduct:
 Sales Taxes OR State Income Taxes
 Whichever is of greater benefit.

NO STATE TAX is paid in Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington and Wyoming. Residents of these states would clearly choose sales tax.

NO SALES TAX is paid in Alaska, Delaware, Montana, New Hampshire, and Oregon. Residents there have no choice. (Note that Alaska and New Hampshire have neither tax!)

GENERAL SALES TAX TABLES will be published in Publication 600.

ADDITION may be made for purchases of vehicles, boats, and other items specified in Publication 600 by IRS.

RECORDS of actual sales tax might be used if higher amount than the tables.

CHOOSE 1 of 3 POSSIBILITIES: For all practical purposes, our Federal filers who are California residents will deduct ONE of the following:

- (a) State income taxes plus SDI as paid or withheld,
- (b) Sales tax from table, plus tax paid on boats, vehicles, motor homes, and other specified items from Publication 600, or
- (c) Sales tax figures based on taxpayer records.

Tax Extenders & AMT Relief Act of 2008.



INPUT ALERT. The sales tax issue demands additional inputs. Look for inputs about additional income even if non-taxable, additional members of household, additional for motor vehicles, boats and other items specified in Publication 600, or even an override box.

**CALIFORNIA NON-CONFORMITY**

NO STATE TAX DEDUCTION FOR CALIFORNIA. California does not allow ANY state tax deduction—whether for income tax or sales tax.



PROPERTY TAX DEDUCTION FOR NON-ITEMIZERS

REAL PROPERTY TAX DEDUCTION is added to the components of the standard deduction for 2008 & 2009. In past years, a standard deduction has been allowed for non-itemizers, with an additional amount allowed for age and blindness. In 2008 & 2009 only, an additional amount is also allowed for real property taxes.

ANY REAL ESTATE TAX may be used, not simply property taxes on a principal residence.

LIMITED TO \$500 (\$1,000 FOR MFJ).

FORM 1040 CHECKBOX is used to signal the deduction is claimed. Form 1040A allows this deduction, but Form 1040-EZ does not.

Housing Assistance Tax Act of 2008 and Tax Extenders & AMT Relief Act of 2008.



CALIFORNIA NON-CONFORMITY

NO ADDITIONAL STANDARD DEDUCTION FOR CALIFORNIA. California does not conform to this increase to the standard deduction.



NEW FOR 2005 & ON—VEHICLE DONATIONS

TOUGH RULES FOR VEHICLE DONATIONS. Beginning in 2005, contributions of motor vehicles, boats, and airplanes with a claimed value over \$500 have:

- (a) deductions which depend upon the charity's use of the asset, and
- (b) higher substantiation requirements.

FORM. Form 1098-C is used to report charitable contributions of vehicles.

1098-C CUTS CAR DONATIONS. Using IRS data, Grant Thornton's National Tax Office says the value of donations of vehicles valued at more than \$500 have declined by more than 80% - from \$2.4 Billion in 2004 to just \$0.5 Billion in 2005. Only vehicle deductions declined – overall contributions increased from \$1.56 billion to \$1.72 billion over the same 2 years.



AFTER AUGUST 17, 2006 – NONCASH CHANGE

CLOTHING & HOUSEHOLD ITEMS – “GOOD OR BETTER” CONDITION. Contributions of clothing or household items to a charitable agency after 8/17/06 must be of “good or better” used condition or no deduction is allowed. Household items include furniture, furnishings, electronics, appliances, linens and other similar items. They do not included food, paintings, antiques or other objects of art, jewelry, gems and collections.

EXCEPTION. For these items only, a deduction is allowed items if their value is over \$500 and a qualified appraisal is included with the tax return. For all other items, a qualified appraisal is needed only if the value exceeds \$5,000.

NO HELP FROM IRS. No guidance has yet been offered by IRS. The decision of what items are in “good or better” condition remains seated with the Taxpayer.

Pension Protection Act Of 2006.



CALIFORNIA CONFORMITY AND DIFFERENCES

EXCLUDABLE CONTRIBUTIONS FROM IRAs – California conforms.

RECEIPTS FOR ALL CONTRIBUTIONS – No conformity

TOUGHER RULES FOR VEHICLE DONATIONS – California conforms

CLOTHING & HOUSEHOLD ITEMS – GOOD OR BETTER – No conformity

SALE OF RESIDENCE

**NEW IN 2008 – DOUBLE EXCLUSION FOR SURVIVING SPOUSE**

\$500,000 EXCLUSION AVAILABLE. Normally each taxpayer may claim a maximum exclusion of \$250,000 upon selling a principal residence under IRC Section 121. Beginning in 2008, a surviving spouse may claim a full \$500,000 upon sale, as long as:

- (1) The sale is within 2 years of death of spouse, and
- (2) Surviving spouse has not remarried by date of sale, and
- (3) The couple would have qualified for a total of \$500,000 of exclusion.

Mortgage Forgiveness Debt Relief Act of 2007

**NEW FOR 2009 – “NONQUALIFIED USE” LIMITS EXCLUSION**

NOT USED AS PRINCIPAL RESIDENCE will lead to a new calculation when selling a residence.

BEST UNDERSTOOD VIA EXAMPLE. We'll remove the box for a detailed explanation of this new provision.

Housing Assistance Tax Act of 2008

HISTORY OF HOME SALE TREATMENT. To best understand the new rules, a sense of what *has been* is helpful.

PRIOR TO MAY 6, 1997 – “ROLLOVERS” UNDER SEC 1034. Prior law allowed for *no exclusion* at all. Instead, a sort of “tax-deferred exchange” rule allowed *deferral* of gain as long as the *cost* of a replacement residence was greater than the amount at which prior residence was *sold*. At age 55, a “once-in-a-lifetime” exclusion of \$125,000 was allowed.

CONSTANT UPGRADES IN COST were required to avoid tax upon sale of a home, and the deferred gain “snowballed”.

MAY 6, 1997 - \$250,000 EXCLUSION INVENTED. Congress knew home ownership is less about *investment* decisions than about decisions dealing with *family* and/or *job* needs. The exclusion was meant to “remove” tax considerations for all but the wealthiest of homeowners.

FINALLY – THE NEW LAW! The Law identifies periods of time as not qualifying for exclusion. These are called

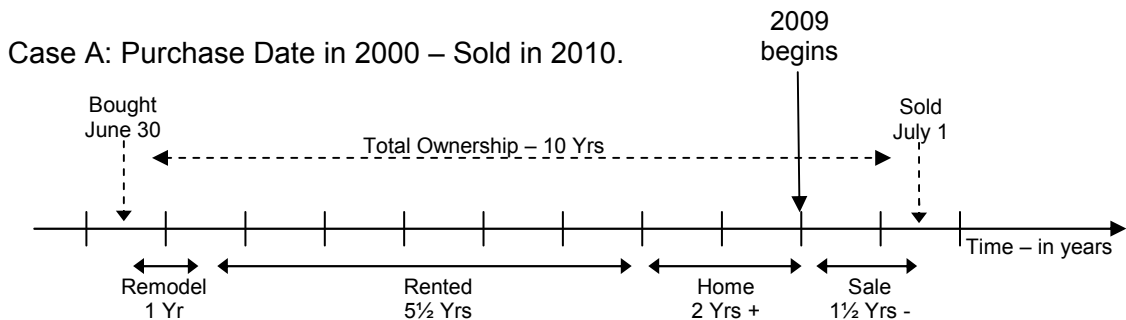
NON-QUALIFIED USE is any use of the property OTHER THAN as a principal residence. This would include the “remodel” period in our example (unless T/P resided there during the work), use as a vacation property, as a rental property, or time while a family member lived there.

EXCEPTIONS: Certain periods of time are ignored completely:

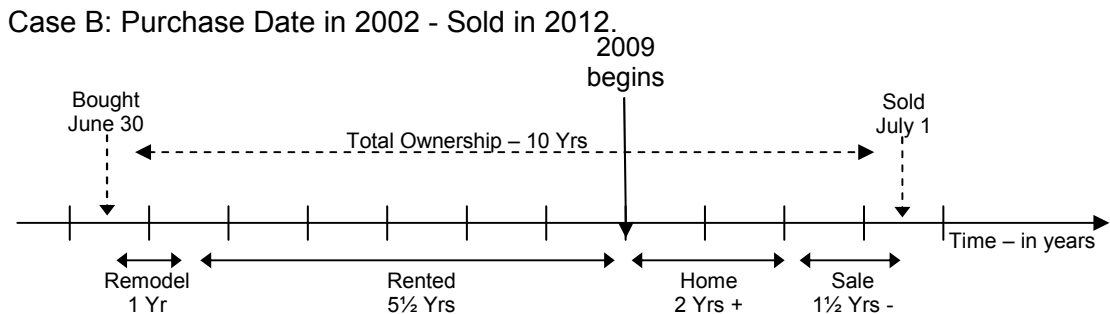
1. **BEFORE 2009** – any use prior to 1/1/2009 is ignored.
2. **PERIODS AFTER LAST USE AS HOME** are ignored if during the 5-year look back period. In our example, this is the “sale” period.
3. **MILITARY & GOVERNMENT SERVICE** folks may be able to ignore up to 10 years of time while on “Qualified Official Extended Duty.”
4. **TEMPORARY ABSENCES** up to two years are allowed for job changes, medical issues, and unforeseen circumstances.

GRADUAL IMPACT is what we will see because of the fact no use prior to 2009 is considered.

RETURN TO THE EXAMPLE and you will see how this new law will GRADUALLY begin to affect taxpayers.

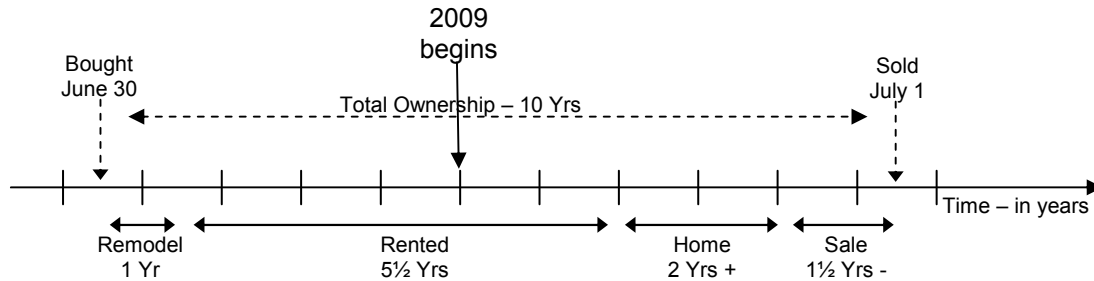


No non-qualified use! All Appreciation gain is subject to Section 121 exclusion. Note: There may have been some depreciation claimed after 5/6/97 – this is NEVER excludable!



Still no non-qualified use! All Appreciation gain is subject to Section 121 exclusion.

Case C: Purchase Date in 2004 – Sold in 2014.

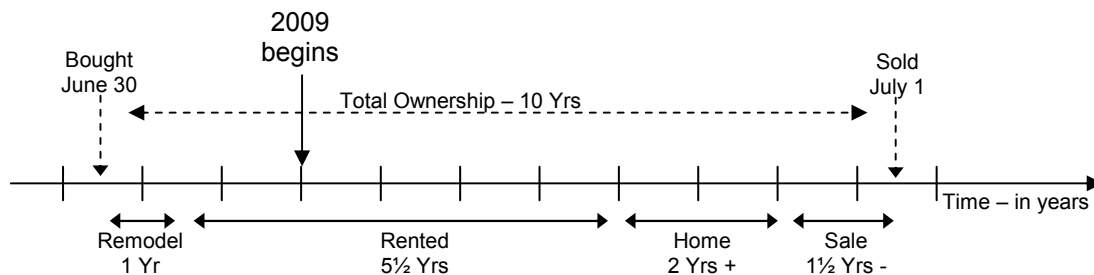


Finally we have non-qualified use! During 2009 and 2010 the property was a rental – 2 years. Thus:

$2/10 = 20\%$ of appreciation (plus any depreciation, of course) is gain from a rental, and will be taxed.

$8/10 = 80\%$ of appreciation gain is subject to Section 121 exclusion.

Case D: Purchase Date in 2006 – Sold in 2016.



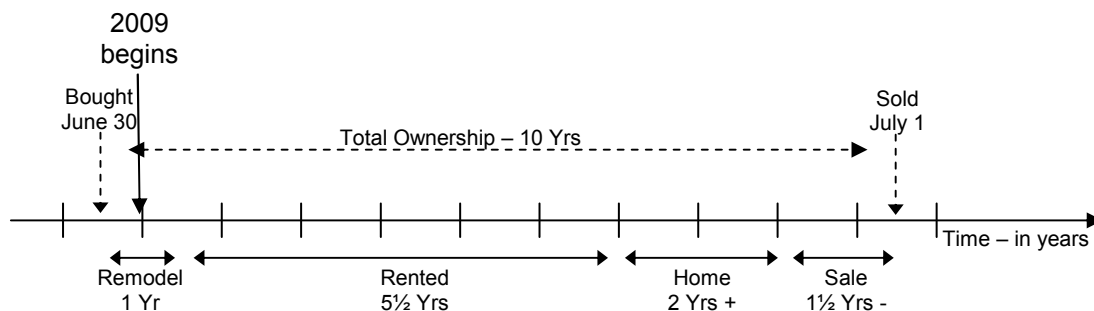
More non-qualified use! From 2009 through 2013 the property was a rental – 4 years.

Thus:

$4/10 = 40\%$ of appreciation (plus any depreciation, of course) is gain from a rental, and will be taxed.

$6/10 = 60\%$ of appreciation gain is subject to Section 121 exclusion.

Case E: Purchase Date in 2008 – Sold in 2018.



More non-qualified use! From 2009 through 2015 the property was a rental – 6 years.

Thus:

$6/10 = 60\%$ of appreciation (plus any depreciation, of course) is gain from a rental, and will be taxed.

$4/10 = 40\%$ of appreciation gain is subject to Section 121 exclusion.

EVENTUALLY we will experience fully this new law.

FORM W-2, 1098 AND 1099 INFORMATION RETURNS

CHARTS FOR CODES

On the next few pages are charts showing important codes for various forms.

2008 REFERENCE GUIDE FOR FORM W-2—BOX 12 CODES

Code	Item
A	Uncollected social security or RRTA tax on tips
B	Uncollected Medicare tax on tips
C	Cost of group term life over \$50K
D	§401(k) and SIMPLE §401(k) elective deferrals
E	§403(b) tax sheltered annuity elective deferrals
F	SAR-SEP (§408(k)(6)) elective deferrals
G	§457(b) deferred compensation elective/non-elective deferrals
H	§501(c)(18)(D) tax exempt organization elective deferrals
J	Nontaxable sick pay (not included in boxes 1, 3 or 5)
K	20% excise tax on excess golden parachute payments
L	Substantiated employee business expense (Federal rate) (Non-taxable)
M	Uncollected social security tax or RRTA on group term life over \$50K (for former employees only)
N	Uncollected Medicare tax on group term life over \$50K (former employees)
P	Excludable reimbursed moving expenses (not included in boxes 1,3 or 5)
Q	Nontaxable combat pay
R	Archer MSA employer contributions (See Form 8853)
S	SIMPLE plan (§408(p)) salary reduction contributions
T	Adoption Benefits (Must complete Form 8839 to determine taxability)
V	Income from exercise of nonstatutory stock option (included in box 1, 3 or 5)
W	Health Savings Account (HSA) employer contributions (See Form 8889)
Y	§409A nonqualified deferred compensation plan deferrals
Z	§409A nonqualified deferred compensation plan income
AA	Designated Roth contributions to a §401(k) plan
BB	Designated Roth contributions to a §403(b) plan

MILEAGE, COMMUTING, ETC.

MILEAGE ALLOWANCES. IRS publishes these annually.

Year	Business miles	Deemed Deprec.	Charitable	Medical or Moving	Source
2009	55¢	21¢	14¢	24¢	Rev. Proc 2008-72
2008 thru 6/30 7/01 – 12/31	50.5¢ 58.5¢	21¢ 21¢	14¢ 14¢	19¢ 27¢	Rev. Proc 2007-70 Ann 2008-63
2007	48.5¢	19¢	14¢	20¢	Rev. Proc 2006-49
2006	44.5¢	17¢	14¢*	18¢	Rev. Proc. 2005-78
2005 thru 8/31 9/01 – 12/31	40.5¢ 48.5¢	17¢ 17¢	14¢* 14¢*	15¢ 22¢	Rev. Proc. 2004-64 & 2005-6
2004	37.5¢	16¢	14¢	14¢	Rev. Proc. 2003-76
2003	36¢	16¢	14¢	12¢	Rev. Proc. 2002-61
2002	36.5¢	15¢	14¢	13¢	Rev.Proc 2001-54
2001	34.5¢	15¢	14¢	12¢	Rev.Proc 2000-48
2000	32.5¢	14¢	14¢	10¢	Rev.Proc 99-38

* Katrina contribution mileage is increased to 70% of the business rate for 2005 & 2006.

FORM 2210 UNDERPAYMENT PENALTY

PENALTY FOR YEAR 2008

THRESHOLD - \$1,000. No penalty can apply unless at least \$1,000 is due.

HIGH INCOME TAXPAYERS. Taxpayers with AGI over \$150,000 on the 2007 return are required to make estimated tax payments of 110% of the 2007 liability or 90% of their 2008 liability.

2009 ESTIMATES



TAX TRAP!!! – PREPARING ESTIMATE VOUCHERS

For 2009, taxpayers with AGI over \$150K are required to pay in withholding or estimated taxes the smaller of 110% of the 2008 liability or 90% of the 2009 liability to avoid estimated tax penalties.



CALIFORNIA DIFFERENCES ESTIMATED TAXES—FORM 5805

NONCONFORMITY. For 2008, no estimated tax is due in California unless the tax due exceeds \$200 (\$100 MFS). For 2009, the amounts are increased to \$500 (\$250 MFS).

NONCONFORMITY. For 2009, taxpayers with AGI in excess of \$1 million (\$500,000 MFS) must pay at least 90% of their 2009 liability to avoid an underpayment penalty. The 110% of the 2008 liability exception is eliminated.

NONCONFORMITY. Beginning in 2009, estimated tax payments will not be made in four equal installments, but must be paid with 30% due for each of the first two vouchers and 20% for the final two vouchers. Problems might occur for taxpayers who only have withholding, as withholding is deemed to be withheld equally throughout the year. In addition, taxpayers with an estimated or extension tax payment in excess of \$20,000 or with a total tax liability in excess of \$80,000, must remit these payments electronically to FTB.

AMOUNT OF ADDITIONAL DEDUCTION. The amount allowed is the “net disaster loss.” This is defined as the allowable disaster loss without regard to the 10% of AGI reduction. Note that personal casualty losses are not included in this additional deduction.

EFFECTIVE DATES. For 2008 & 2009 only.

Emergency Economic Stabilization Act of 2008.



CALIFORNIA NON-CONFORMITY

NO CONFORMITY FOR CALIFORNIA. California does not conform to any of the new Federal rules shown in the above two boxes.



2008 CALIFORNIA DISASTER LOSSES

OVERVIEW. There were two combined Federal/California and three California only declared disasters in California in 2008. The disasters have been deemed by the California legislature to be eligible to carryover 100% of any excess disaster loss for up to 15 years and to make the §165(i) carry back election by the extended due date of the return for the year in which the disaster occurred. See FTB Publication 1034. The two combined Federal/California disasters are also eligible for the new Federal law discussed above.

COMBINED FEDERAL/CALIFORNIA DISASTERS—Both California Wildfires—The first occurred between June 28 and August 20, 2008. The counties declared disaster areas are: Butte, Kern, Mariposa, Mendocino, Monterey, Plumas, Santa Barbara, Santa Clara, Shasta and Trinity. The second began on November 13, 2008. The counties declared disaster areas are: Los Angeles, Orange, Riverside and Santa Barbara.

OTHER CALIFORNIA ONLY DISASTERS

- (1) Wildfires—Occurred in July 2008 in Santa Barbara county.
- (2) Wildfires—Began in May 2008 in Humboldt county.
- (3) Rainstorms, flooding & landslides—Occurred in July 2008 in Inyo county.

CLAIMING THE LOSS.

If clients suffered the disaster loss in 2008, they may either:

Claim the loss on an original or amended 2007 return, and file it by the extended due date (October 15, 2009 for calendar year taxpayers); or

Claim the loss on the 2008 original return.

**PUBLIC SAFETY EMPLOYEES EXCEPTION**

PUBLIC SAFETY EMPLOYEES EXCEPTION. The 10% early withdrawal penalty is waived certain pension distributions made to qualified public safety officers. The penalty does not apply to a Section 414(d) defined benefit governmental plan if the public safety officer has separated from service after attaining age 50.

QUALIFIED PUBLIC SAFETY EMPLOYEE is any employee of a state (or political subdivision) who provides police protection, firefighting services or emergency medical services for any area within the jurisdiction of the state (or political subdivision).

EFFECTIVE DATE. For distributions after 8/17/2006.

Pension Protection Act Of 2006.

**CALIFORNIA DIFFERENCES – PENALTY EXCEPTIONS**

CONFORMITY. California has conformed to all Federal exceptions.

**CALIF PENALTY IS DEDUCTIBLE ON FEDERAL RETURNS**

California's 2 ½% additional tax on early distribution from a qualified retirement plan is deductible as a state tax for Federal purposes. Although the additional tax is referred to as a "penalty" in R&TC Section 17085(c), it is in fact a tax.

Office of Chief Counsel IRS Memorandum 20072201F, dated 04-13-2007.

REFERENCE GUIDE TO PENALTY EXCEPTIONS. The 2008 Reference Guide for Form 5329 Exceptions follows on the next page.



TAX TRAP!!! REDUCED CREDIT FOR TOYOTA & HONDA

TOYOTA AND HONDA SELL MORE THAN 60,000 QUALIFIED HYBRID VEHICLES. Toyota reached the limit of 60,000 qualified hybrid vehicles during the 2nd quarter of 2006 and Honda reached this limit during the 3rd quarter of 2007. Thus future credits will be reduced. The law states that for the 1st quarter following the quarter in which 60,000 vehicles are sold, the full credit is still allowed. For the 2nd & 3rd quarter following, the allowable credit is 50% of the full credit. For the 4th & 5th quarter following, the allowable credit is 25% of the full credit. No credit is allowed after the 5th quarter.

NO CREDIT--TOYOTA. Toyota (which includes Lexus models) reached the limit in the 2nd quarter of 2006. Thus no credit was allowed for their vehicles in 2008.

REDUCED CREDIT--HONDA. Honda reached the limit in the 3rd quarter of 2007. The following is the scheduled phase-out of this credit on Honda vehicles.

Sales through 12-31-2007	100% of full credit
Sales from 01-01-2008 thru 06-30-2008	50% of full credit
Sales from 07-01-2008 thru 12-31-2008	25% of full credit
Sales from 01-01-2009 and after	0% of full credit.

Since no other auto manufacturer reached this limit by the end of the 3rd quarter of 2008, the full credit is allowed for all of their hybrid vehicles in 2008.

Energy Policy Act of 2005.



NEW PLUG-IN VEHICLE CREDIT

OVERVIEW. A credit is available if the taxpayer places a "new qualified plug-in electric drive motor vehicle" (NQPEDMV) in service after 2008 and before 2015. Code §30D covers this credit. As with the hybrid credit above, the vehicle must be a new vehicle (not used). The credit consists of a \$2,500 base amount that is increased for battery capacity and limited by vehicle weight up to a maximum credit of \$7,500 to \$15,000. After 250,000 vehicles are sold in the U.S., the credit is further reduced identical to the schedule shown above. The credit will be allowed to offset regular tax and AMT (reduced by certain other credits). T/P may elect out of this credit. Many additional limitations and definitions apply.

2008 Energy Act



CALIFORNIA DIFFERENCES

California does not conform to these Federal credits.



PRACTICE NOTE – TAX RETURN PENALTIES MODIFIED

UNREASONABLE POSITION. A tax return preparer who prepares a return or refund claim for which any part of a tax liability understatement is due to an “unreasonable position” must pay a penalty for each return or claim equal to the greater of (1) \$1,000 or (2) 50% of the income derived by the preparer for preparing the return or claim. (Code Section 6694(a)).

NOT A TAX SHELTER OR REPORTABLE TRANSACTION. If the position is not disclosed as provided in Code Section 6662(d)(2)(B)(ii)(I), the position is “unreasonable” if (1) the preparer knew (or reasonably should have known) of the position and (2) there is or was substantial authority for the position. (This replaces the “more likely than not” standard proposed by the 2007 Small Business Act). “Substantial authority” exists if the weight of authorities that support the taxpayer’s treatment is substantial in relation to the weight of those that take a contrary position.

If the position is disclosed as provided in Code Section 6662(d)(2)(B)(ii)(I) and isn’t a position described in the rules for tax shelters and reportable transactions, the position is unreasonable unless there is a reasonable basis for the position. Normally, Form 8275 Disclosure Statement, attached to the return, satisfies the disclosure requirement under Section 6662. (This replaces the “more likely than not” standard proposed by the 2007 Small Business Act).

TAX SHELTERS OR REPORTABLE TRANSACTIONS. A position is unreasonable unless it is reasonable to believe that the position would more likely than not be sustained on its merits. This applies whether disclosure is made. This retains the “more likely than not” standard proposed by the 2007 Small Business Act. This penalty will not be imposed if it is shown that there is reasonable cause for the understatement and the preparer acted in good faith.

WILLFUL OR RECKLESS CONDUCT. A tax return preparer who prepares a return or refund claim for which any part of a tax liability understatement is due to “willful or reckless conduct” must pay a penalty for each return or claim equal to the greater of (1) \$5,000 or (2) 50% of the income derived by the preparer for preparing the return or claim. (Code Section 6694(b)).

“Willful or reckless conduct” is conduct by the preparer which is (1) a willful attempt to understate the tax liability on the return or claim, or (2) a reckless or intentional disregard of rules and regulations. Any penalty payable by a person due to willful or reckless conduct will be reduced by the penalty paid by that person due to an unreasonable position.

DEFINITION OF A TAX RETURN PREPARER. The law also amends the definition of tax preparer to include preparers of income tax returns as well as preparers of estate, gift, employment and excise tax returns. “Income tax preparer” in the code will be replaced by “tax return preparer”.

EFFECTIVE DATE. For any returns prepared after 05-25-2007 with final regulations effective for returns prepared after 12-31-2008.

2007 Small Business Act, Emergency Economic Stabilization Act of 2008, TD9436, Notice 2009-5 and Rev Proc 2009-11.

**INTEREST RATES CHARGED OR PAID
BY IRS AND FTB**

Period	IRS Rate	FTB Rate
2009		
10/01 – 12/31		
07/01 – 9/30		
04/01 – 06/30		5%
01/01 – 03/31	5%	5%
2008		
10/01 – 12/31	6%	7%
07/01 – 9/30	5%	7%
04/01 – 06/30	6%	8%
01/01 – 03/31	7%	8%
2007		
10/01 – 12/31	8%	8%
07/01 – 9/30	8%	8%
04/01 – 06/30	8%	8%
01/01 – 03/31	8%	8%
2006		
10/01 – 12/31	8%	7%
07/01 – 9/30	8%	7%
04/01 – 06/30	7%	6%
01/01 – 03/31	7%	6%
2005		
10/01 – 12/31	7%	5%
07/01 – 9/30	6%	5%
04/01 – 06/30	6%	4%
01/01 – 03/31	5%	4%
2004		
10/01 – 12/31	5%	4%
07/01 – 9/30	4%	4%
04/01 – 06/30	5%	5%
01/01 – 03/31	4%	5%
2003		
10/01 – 12/31	4%	5%
07/01 – 9/30	5%	5%
04/01 – 06/30	5%	6%
01/01 – 03/31	5%	6%
2002		
10/01 – 12/31	6%	6%
07/01 – 9/30	6%	6%
04/01 – 06/30	6%	7%
01/01 – 03/31	6%	7%
2001		
10/01 – 12/31	7%	9%
07/01 – 9/30	7%	9%
04/01 – 06/30	8%	9%
01/01 – 03/31	9%	9%