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Annual Tax Newsletter

WHAT YOU NEED TO KNOW BEFORE FILING YOUR 2010 TAXES

"When you don't fully understand tax laws, you may pay too much or risk an audit!"

There were numerous changes to the tax provisions for 2010: head of household standard deduction, standard mileage deduction, earned income credit, and American Opportunity tax credit, to name just a few. How can you be sure you're receiving the maximum benefits you merit under the law? Just ask your Enrolled Agent. Your EA is a tax professional with expertise in the continually changing field of taxation.

EAs…

- advise, represent, and prepare tax returns for individuals, partnerships, corporations, estates, trusts and other entities;
- have strenuous requirements, both to obtain enrollment and to maintain the license through stringent, comprehensive tax education;
- specialize in taxation, and are the only taxpayer representatives who receive their right to practice from the U.S. government;
- are respected as "The" Tax Professionals!

2010 Tax News That Affects Individuals

The American Opportunity Tax Credit

- The American Opportunity Tax Credit is part of the American Recovery and Reinvestment Act of 2009 and is available through December 31, 2010. This tax credit can help many parents and college students offset the cost of college, and can be claimed by eligible taxpayers for college expenses paid in 2009 and 2010.

Here are some important facts about the American Opportunity Tax Credit:

- This credit, which expands and renames the existing Hope Credit, can be claimed for qualified tuition and related expenses that you pay for higher education in 2009 and 2010. Qualified tuition and related expenses include tuition, related fees, books and other required course materials. The term "course materials" means books, supplies, and equipment needed for a course of study whether or not the materials are purchased from the educational institution as a condition of enrollment or attendance.
- The credit is equal to 100 percent of the first $2,000 spent per student each year and 25 percent of the next $2,000. Therefore, the full $2,500 credit may be available to a taxpayer who pays $4,000 or more in qualifying expenses for an eligible student.
- The full credit is generally available to eligible taxpayers who make less than $80,000 or $160,000 for married couples filing a joint return. The credit is gradually reduced, however, for taxpayers with incomes above these levels.
- Forty percent of the credit is refundable, so even those who owe no tax can get up to $1,000 of the credit for each eligible student as cash back. However, none of the credit is refundable if the taxpayer claiming the credit is a child (a) who is under age 18 (or a student who is at least age 18 and under age 24 and whose earned income does not exceed one-half of his or her own support), (b) who has at least one living parent, and (c) who does not file a joint return.
- The credit can be claimed for qualified expenses paid for any of the first four years of post-secondary education.
- You cannot claim the tuition and fees tax deduction in the same year that you claim the American Opportunity Tax Credit or the Lifetime Learning Credit. You must choose to either take the credit or the deduction. Ask your Enrolled Agent which is more beneficial for you. Your EA can help you understand and make the most of this tax credit.

Nonbusiness Energy Property Credit

The Nonbusiness Energy Property Credit is a tax credit for making energy efficient improvements to homes, and was increased as part of the American Recovery and Reinvestment Act of 2009.

- The new law increases the credit rate to 30 percent of the cost of all qualifying improvements and raises the maximum credit limit to $1,500 claimed for 2009 and 2010 combined.
- The credit applies to improvements such as adding insulation, energy-efficient exterior windows and energy-efficient heating and air conditioning systems.
- Manufacturers must certify that their products meet new standards and they must provide a written statement to the taxpayer such as one included with the packaging of the product or in a printable format on the manufacturers' website.
- Qualifying improvements must be placed into service after December 31, 2008, and before January 1, 2011.
- The improvements must be made to the taxpayer's principal residence located in the United States.
- Taxpayers must claim the credit on the tax return for the year that the improvements are made. Get more information on how to file for this credit from your Enrolled Agent.

Changes Coming for Health Flexible Spending Accounts (FSAs) and Health Savings Accounts (HSAs)

The health care reform law requires that beginning with medical expenses incurred on or after January 1, 2011, employees will no longer be able to receive reimbursement from their health flexible spending accounts (FSAs) or health savings accounts (HSAs) for non-prescription, over-the-counter (OTC) items. Instead, reimbursements will be limited to expenses incurred for prescription drugs, OTC items for which employees have prescriptions, or insulin. This new rule also impacts employees who use debit cards linked to FSAs or HSAs.

This new restriction applies to items purchased beginning on or after January 1, 2011, regardless of the plan year. Employees will need to present substantiation (e.g., a copy of the prescription and the receipt) before their FSAs can reimburse them for prescription OTC items, with some exceptions.

This new restriction doesn't apply to co-pays and deductibles. Nor does it apply to crutches, eyeglasses, contact lenses, supplies such as bandages, and diagnostic devices such as blood sugar test kits. These may qualify as medical care (and, therefore, reimbursement) if they meet the tax code's definition.

The same rule applies to HSAs, although HSAs do not have any substantiation requirements. Employees who use their HSAs for non-prescription OTC items must include the distribution in income and pay a 20% penalty.

This new rule also impacts debit-cards-linked FSAs and HSAs. For FSA-linked debit cards only, it won't challenge employees' use of debit cards for expenses incurred through January 15, 2011.Beginning on or after January 16, 2011, employees who buy OTC medicine or drugs must present substantiation before receiving reimbursement from their FSAs.

Cafeteria plans must be amended to comply with this new rule. The IRS will allow cafeteria plans to be amended by June 30, 2011; the amendment may be made effective retroactively for expenses incurred after December 31, 2010, or January 16, 2011, for debit card purposes.

2010 California Tax Rates and Exemptions

The rate of inflation in California, for the period from July 1, 2009 through June 30, 2010, was 0.9%. The 2010 personal income tax brackets are indexed by this amount.

Corporate tax rates

Entity type	Tax rate
Corporations other than banks and financials	8.84%
Banks and financials	10.84%
Alternative Minimum Tax (AMT) rate	6.65%
S corporation rate	1.5%
S corporation bank and financial rate	3.5%

Individual tax rates

- The maximum rate for individuals is 9.55%
- The AMT rate for individuals is 7.25%
- The Mental Health Services Tax Rate is 1% for taxable income in excess of $1,000,000.

Exemption credits

Filling Status/Qualification	Exemption amount
Married/Registered Domestic Partner (RDP) filing jointly or qualifying widow(er)	$198
Single, married/RDP filing separately, or head of household	$99
Dependent	$99
Blind	$99
Age 65 or older	$99

Phaseout of exemption credits

Higher-income taxpayers' exemption credits are reduced as follows:

Filling Status	Reduce each credit by:	For each:	Federal AGI exceeds:
Single	$6	$2,500	$162,186
Married/RDP filing separately	$6	$1,250	$162,186
Head of household	$6	$2,500	$243,283
Married/RDP filing jointly	$12	$2,500	$324,376
Qualifying widow(er)	$12	$2,500	$324,376

When applying the phaseout amount, apply the $6/$12 amount to each exemption credit, but do not reduce the credit below zero. If a personal exemption credit is less than the phaseout amount, do not apply the excess against a dependent exemption credit.

Standard deductions

The standard deduction amounts for:

Filling Status	Deduction amount
Single or married/RDP filing separately	$3,670
Married/RDP filing jointly, head of household, or qualifying widow(er)	$7,340
The minimum standard deduction for dependents	$950

Reduction in itemized deductions

Itemized deductions must be reduced by the lesser of 6% of the excess of the taxpayer's federal AGI over the threshold amount or 80% of the amount of itemized deductions otherwise allowed for the taxable year.

Filing status	AGI threshold
Single or married/RDP filing separately	$162,186
Head of household	$243,283
Married/RDP filing jointly or qualifying widow(er)	$324,376

Nonrefundable Renter's credit

This nonrefundable, non-carryover credit for renters is available for:

- Single or married/RDP filing separately with a California AGI of $34,722 or less.
  - The credit is $60.
- Married/RDP filing jointly, head of household, or qualifying widow(er) with a California AGI of $69,444 or less.
  - The credit is $120.

Miscellaneous credits

- **Qualified senior head of household credit**
  - 2% of California taxable income
  - Maximum California AGI of $63,440
  - Maximum credit of $1,196
- **Joint custody head of household credit/dependent parent credit**
  - 30% of net tax
  - Maximum credit of $390 AMT exemption

AMT exemption

Filing status	Amount
Married/RDP filing jointly or qualifying widow(er)	$79,526
Single or head of household	$59,646
Married/RDP filing separately, estates, or trusts	$39,762

AMT exemption phaseout

Filing status	Amount
Married/RDP filing jointly or qualifying widow(er)	$298,224
Single or head of household	$223,669
Married/RDP filing separately, estates, or trusts	$149,111

FTB cost recovery fees

Fee type	Fee
Bank and corporation filing enforcement fee	$113
Bank and corporation collection fee	$291
Personal income tax filing enforcement fee	$100
Personal income tax collection fee	$170

The personal income tax fees apply to individuals and partnerships, as well as limited liability companies that are classified as partnerships. The bank and corporation fees apply to banks and corporations, as well as limited liability companies that are classified as corporations. Interest does not accrue on these cost recovery fees.

2010 California Tax Rate Schedules

Schedule X — Single or married/RDP filing separately

If the taxable income is				
Over	But not over	Tax is		Of amount over
$0	$7,124	$0.00	Plus 1.25%	$0
$7,124	$16,890	$89.05	Plus 2.25%	$7,124
$16,890	$26,657	$308.79	Plus 4.25%	$16,890
$26,657	$37,005	$723.89	Plus 6.25%	$26,657
$37,005	$46,766	$1,370.64	Plus 8.25%	$37,005
$46,766	And over	$2,175.92	Plus 9.55%	$46,766

Schedule Z — Head of household

If the taxable income is				
Over	But not over	Tax is		Of amount over
$0	$14,257	$0.00	Plus 1.25%	$0
$14,257	$33,780	$178.21	Plus 2.25%	$14,257
$33,780	$43,545	$617.48	Plus 4.25%	$33,780
$43,545	$53,893	$1,032.49	Plus 6.25%	$43,545
$53,893	$63,657	$1,679.24	Plus 8.25%	$53,893
$63,657	And over	$2,484.77	Plus 9.55%	$63,657

Schedule Y — Married/RDP filing jointly, or qualifying widow(er) with dependent child

If the taxable income is				
Over	But not over	Tax is		Of amount over
$0	$14,248	$0.00	Plus 1.25%	$0
$14,248	$33,780	$178.10	Plus 2.25%	$14,248
$33,780	$53,314	$617.57	Plus 4.25%	$33,780
$53,314	$74,010	$1,447.77	Plus 6.25%	$53,314
$74,010	$93,532	$2,741.27	Plus 8.25%	$74,010
$93,532	And over	$4,351.84	Plus 9.55%	$93,532

This Newsletter was provided as a courtesy to the clients and friends of a proud Member of:
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Individual Filing Requirements

If your gross income or adjusted gross income is more than the amount shown in the chart below for your filing status, age, and number of dependents, then you have a filing requirement.

Filing Status	Age as of December 31, 2010*	California Gross Income			California Adjusted Gross Income		
		Dependents			Dependents		
		0	1	2 or more	0	1	2 or more
Single or head of household	Under 65	14,754	18,054	20,529	11,803	15,103	17,578
	65 or older	19,704	22,179	24,159	16,753	19,228	21,208
Married/RDP filing jointly or separately	Under 65 (both spouses/RDPs)	29,508	32,808	35,283	23,607	26,907	29,382
	65 or older (one spouse)	34,458	36,933	38,913	28,557	31,032	33,012
	65 or older both spouses/ RDPs)	39,408	41,883	43,863	33,507	35,982	37,962
Qualifying widow(er)	Under 65	N/A	18,054	20,529	N/A	15,103	17,578
	65 or older	N/A	22,179	24,159	N/A	19,228	21,208
Dependent of another person (Any filing status)	Under 65	More than your standard deduction					
	65 or older	More than your standard deduction					

* If you turn 65 on January 1, 2011, you are considered to be age 65 at the end of 2010.

Enrolled Agents: "*The*" Tax Professionals

Why is it important that my tax professional be a Member of the California Society of Enrolled Agents (CSEA)?

Enrolled Agents (EAs) are licensed by the federal government and authorized to represent taxpayers before the Internal Revenue Service. The Enrolled Agent profession dates back to 1884, when representatives were licensed and regulated to help U.S. citizens with Civil War claims.

EAs advise, represent and prepare tax returns for individuals, partnerships, corporations, estates, trusts and any entities with tax-reporting requirements. They are required to complete 72 hours of continuing professional education, reported every three years, to maintain their EA license. **CSEA Members, however must complete 20% more education – a full 90 hours every three years.**

The strenuous requirements to become an EA ensure that only the top tax professionals earn the designation. Because of the difficulty in becoming an Enrolled Agent and keeping up the required credentials, it's estimated that there are only about 45,000 EAs worldwide. That's why they are "*The*" Tax Professionals!

How can I be sure my tax professional belongs to the California Society of Enrolled Agents?

Because of the more stringent education and ethics requirements of our Members, you want to be sure that your tax professional belongs to the California Society of Enrolled Agents. Call toll-free 1-800/777- 2732 to ensure that you've got a Member, Affiliate, or Associate working for you as "*The*" Tax Professional!

Keeping Good Records Reduces Stress at Tax Time

Maintaining good records can make filing your return a lot easier, and it will help you remember transactions you made during the year. Here are a few things you should know about recordkeeping.

Generally speaking, you should keep any and all documents that may have an impact on your tax returns. Keep your records in a safe place. You may wish to organize them by year and type of income or expense, or keep all records related to a particular item in a designated envelope. Keeping well-organized records also ensures you can answer questions if your return is selected for examination or prepare a response if you receive a notice.

Individual taxpayers should usually keep the following records supporting items on their tax returns for at least three years:

- Bills
- Credit card and other receipts
- Invoices
- Mileage logs
- Canceled, imaged or substitute checks or any other proof of payment
- Any other records to support deductions or credits you claim on your return

You should normally keep records relating to property until at least three years after you sell or otherwise dispose of the property. Examples include:

- A home purchase or improvement
- Stocks and other investments
- Individual Retirement Arrangement transactions
- Rental property records

If you are a small business owner, you must keep all your employment tax records for at least four years after the tax becomes due or is paid, whichever is later. Examples of important documents business owners should keep Include:

- Gross receipts: Cash register tapes, bank deposit slips, receipt books, invoices, credit card charge slips and Forms 1099-MISC
- Proof of purchases: Canceled checks, cash register tape receipts, credit card sales slips and invoices
- Expense documents: Canceled checks, cash register tapes, account statements, credit card sales slips, invoices and petty cash slips for small cash payments
- Documents to verify your assets: Purchase and sales invoices, real estate closing statements and canceled checks

Be sure to ask your Enrolled Agent or tax professional if you have any questions about what kinds of records you should keep, or how long you should keep them. Your Enrolled Agent can answer questions about how the law applies to your individual tax returns, and help you resolve any tax problems.

Common Errors to Avoid at Tax Time

Errors made on tax returns may delay the processing of your tax return, which in turn, may cause your refund to arrive later. Here are some common errors to avoid in order to guarantee that your refund arrives on time.

- **Incorrect or missing Social Security Numbers**
  When providing SSNs for anyone listed on your tax return, be sure they are exactly as they appear on the Social Security cards.
- **Incorrect or misspelling of dependent's last name**
  When providing a dependent's last name on your tax return, ensure it is exactly as it appears on the Social Security card.
- **Filing status errors**
  Make sure your filing status complies with your situation. There are five filing statuses: Single, Married Filing Jointly, Married Filing Separately, Head of Household, and Qualifying Widow(er) With Dependent Child. Your Enrolled Agent can help you determine your correct filing status.
- **Math errors**
  When gathering information for your tax professional, be sure to take your time and review all math for accuracy.
- **Incorrect bank account numbers for Direct Deposit**
  Make sure that the financial institution routing and account numbers you provide for the return for a direct deposit of your refund are accurate. Incorrect numbers can cause the refund to be delayed or misdirected.

Providing your Enrolled Agent with the correct information will expedite the filing process and ensure that you receive your refund as quickly as possible.

Four Tips for Preparing for a Disaster

Planning what to do in case of a disaster is an important part of being prepared. Some simple steps can help taxpayers protect financial and tax records in case of disasters.

- **Recordkeeping**
  Take advantage of paperless recordkeeping for financial and tax records. Many people receive bank statements and documents by email. This method is an outstanding way to secure financial records. Important tax records such as W-2s, tax returns and other paper documents can be scanned onto an electronic format. You can copy them onto a 'key' or 'jump drive' periodically and then keep the electronic records in a safe place.
- **Document Valuables**
  It's a good idea to compile a room-by-room list of your belongings. One option is to photograph or videotape the contents of your home, especially items of greater value. You should store the photos in a safe place away from the geographic area at risk. This will help you recall and prove the market value of items for insurance and casualty loss claims.
- **Update Emergency Plans**
  Emergency plans should be reviewed annually. Individual taxpayers should make sure they are saving documents everybody should keep including such things as W-2s, home closing statements and insurance records. Make sure you have a means of receiving severe weather information; if you have a NOAA Weather Radio, put fresh batteries in it. Make sure you know what you should do if threatening weather approaches.
- **In the Event of a Disaster**
  If you have been impacted by a federally declared disaster, you may receive copies or transcripts of previously filed tax returns from the IRS free of charge. Your Enrolled Agent can help you submit the required forms in order to correctly make your request.