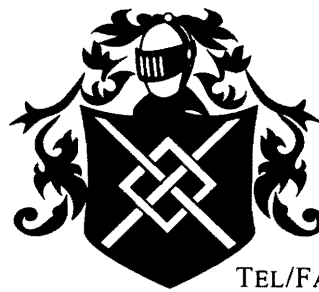


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TAX NEWS & TIPS

FALL 2010

More Tasks Than Time

It's true for Congress. It's true for you. It's true for me.

Congress has a full plate. Third year of global recession. The war on terror goes on. Energy and pollution are bigger concerns than ever.

As I send this off to be printed, July is gone. Congress will meet briefly, then break for the elections. Another short session late this year, but any really important changes will wait for the new Congress convening in January.

You and I face the world of your income tax. Several familiar laws have expired. But, they *might* still be extended. More are set to expire at the end of this year. I'll discuss some important ones in this issue, but I must warn you - - - *both* of us must be prepared for last-minute changes in tax laws.

If Congress Does Nothing At All - - -

Several "temporary" laws were enacted over the past 10 years or so. 2010 is the last year for many of them. Congress does this to allow future legislatures to "fine-tune" new ideas after some experience with them. This seems wise. Problem - important *new* issues pop up. (Did I forget to mention natural disasters and big oil spills?) Congress has had a lot to deal with. However, in just a few months we face massive changes in tax laws. Suppose Congress can't find the time to deal with these.

☑ **Two Examples.** Let's look at a couple of ordinary families. We'll look at their 2010 income tax bills under current laws. Then I'll show you their 2011 tax bill assuming our laws simply follow what is "on the books" at this time.

① **Retired Couple.** Frank and Mary are both 67, and retired. Their income consists of interest and dividends, a pension, and social security for each of them. They use the standard deduction. Here are the numbers:

Interest income	\$ 1,000
Dividend income	\$ 2,000
(\$1,500 "qualified" dividend, plus \$500 capital gain distribution)	
Pension	\$ 30,000
Social Security	\$ 25,000

Now lets compare their income tax bills for 2010 and 2011:

	2010	2011
Income tax:	\$ 1,771	\$ 3,166

Wow! How can the 2011 tax be so high? Easy. The 10% tax bracket is set to expire. Relief from "Marriage Penalty" expires, cutting the standard deduction. The capital gain: We use a split rate - 0% for incomes below the 25% tax bracket, 15% above this. No tax at all for our couple! In 2011 the rate goes to 10%. The qualified dividend is even worse. In 2010 the tax is figured as if this were a capital gain - no tax! In 2011 the dividends will be "ordinary" income. They'll be taxed at 15%.

② **Working Couple.** John and Marsha both work, and have two children in grade school. Their income is from wages, and they also use the standard deduction.

Their income:

Wages	\$ 70,000
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What do they pay?

	2010	2011
Starting tax:	\$ 5,439	\$ 6,555
Less: Child Credit	\$ 2,000	\$ 1,000
Less: Tax Credit for Workers:	\$ 800	\$ 0
Total paid to government:	\$ 2,639	\$ 5,555

Ouch! Again, no 10% tax bracket and reduced standard deduction make a big change. For children

under age 17, the child credit is set to drop from \$1,000 to \$500. The special "Making Work Pay" tax credit of \$800 expires after 2010.

What Can We Expect? I wish I could tell you! The entire point of these examples is to let you know just how unsettled tax laws are for *both* 2010 and 2011.

One of my biggest fears lies in trying to help you plan for the impact of coming changes.

Some 2010 rules may still change before Tax Time. In fact, we might see a year like 2006, when IRS had already released forms before some last-minute changes in December. There were a couple of valuable deductions allowed by law, but IRS forms had no lines to claim them!

Worse - I may not know the 2011 rules until *after* I've prepared your 2010 return - *and* helped make plans for 2011. What do we do then?

Will we see new and unexpected rules? Some expiring tax breaks will be extended, but which ones? You could be left with a serious shortfall in your withholding or estimated tax payments. Tax planning is a risky proposition.

This Issue

- **More Tasks Than Time**
- **If Congress Does Nothing At All - - -**
- **Owning vs. Renting - Time To Switch?**
- **Energy Credits Are Alive and Well**
- **Items To Watch**
- **Looking For Work? Track All Expenses!**
- **Tips For You**
- **Your Tax Calendar**

Owning vs. Renting – Time To Switch?

Most folks set a goal of owning their own home. A smaller number prefer the simplicity and freedom of renting. When you consider making a switch from one to the other, cost is a major factor. That's where I come in – income tax distorts the numbers.

Tax Deductions. It's very simple. Homeowners can deduct mortgage interest and property tax they pay. There's a limited ability to deduct mortgage insurance premiums, but this is supposed to expire after 2010. (*Mortgage* insurance, not *homeowner* insurance.) Normally, you may not deduct utility bills, maintenance, repairs, furniture, or improvements. Just interest and taxes.

Claiming Deductions. Anyone can use the "standard deduction". At present it's \$5,700 for single filers, twice as much for a couple. Suppose you're a single renter, and typically have \$4,000 worth of deductions from state taxes, charity, and some job expenses. If you buy a home, the first \$1,700 of new deductions from interest and taxes on the property

won't save you a penny. Only the excess helps.

Tax Brackets change the real cost of your deductions. The higher your income, the higher the tax on your uppermost dollars. New deductions remove some of these dollars. Spend \$1,000 on a deductible item and your taxes go down. A wealthy taxpayer might see brackets of 35% for federal tax, plus another 10% to the state. The \$1,000 deduction reduces his tax by \$450, leaving a net cost of \$550. One with modest income might see only a \$150 federal savings, and no state savings at all.

Example. Imagine a renter paying \$1,500 monthly rent is shopping for a home. He might see a home needing a \$220,000 mortgage, plus payments for taxes and hazard insurance. The total obligation is \$2,000 monthly. His first impression is "Wow, I could never afford the extra \$500 a month!"

Nearly Equal! After we take account of the tax savings, the real cost might be nearly identical to the current \$1,500 in rent. The \$2,000 monthly payment includes \$900 or \$1,000 in interest, plus another few hundred for taxes. Depending upon income and tax bracket, the "after-

taxes" value of the \$2,000 is likely between \$1,400 and \$1,700. The new \$2,000 might have the same "feel" as the familiar \$1,500 rent.

Switch to Rent – Reverse This!

Today we see folks forced out of their homes for a variety of reasons. If you abandon a property with the same \$2,000 monthly cost, you might find a rental at \$1,500. Whoops! Your tax deductions are now gone. Your income tax bill is going up! It might increase by \$500 monthly. If so, it will still "feel" the same as before. You have the same sad problem.

Your Case – Call Me! Each taxpayer (and property) is unique. If you face a change, I can help. Whether you're buying a home, or moving out in favor of renting, the numbers are deceptive. You are used to *one* position. To evaluate the *other* involves taxes. I can help you get a "feel" for the real numbers. Please call me.

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Energy Credits Are Alive And Well

Two Credits help homeowners – one for saving energy, one for making it.

Energy-conscious homeowners can "partner" with the government to help cover improvement costs. Easiest way to understand the programs is to distinguish between *conserving* energy, and actually *generating* it.

Conserving Energy - Main Home Only. For '09 and '10, you can get tax breaks for energy-saving changes in your home. Insulation, energy-saving windows and doors, and high efficiency heating and cooling devices. Main home only, not a vacation home or a rental.

Limits. You can get a 30% rebate on your tax return for the first \$5,000 spent in 2009 and 2010 combined. That's up to a \$1,500 tax reduction. Once expenses pass \$5,000 you're on your own – no more credits.

Which Items? Check with the manufacturer. There are complicated engineering standards. IRS says we can rely on manufacturer's statements, so keep a copy of their brochure. They advertise these savings loudly.

Which Costs? A little tricky here. For some items you may include only the cost of the item or materials, but not installation costs. For others, you can include installation costs. Roughly speaking, no installation costs are allowed for windows, doors, or insulation – the "handy" homeowner might install these himself. With items like furnaces or air conditioners you can include installation – these often require permits and inspections. Play safe, and keep records of all costs separately.

Generating Energy – Any Residence. Generating energy is good for America's future. That's why the tax incentives exist. The credits for *generating* energy are bigger, better, and more extensive.

Which properties? Any residence you occupy personally, but not a rental. You could do this with multiple properties.

What Kind of Measures? Solar panels to generate electricity or heat are the most common. Energy from wind, geothermal, or fuel cells also counts. Only items serving living areas qualify – nothing for pools or spas. Include all costs involved in the project. If you get subsidies or rebates from the power company or your state, your credit is based on your net cost.

How Much? The credit is a flat 30% of your cost, with no upper limits. These measures are costly. If you spend \$40,000, you get a guaranteed \$12,000 tax break. If your credit exceeds your tax, you can carry the excess to future years, until you get the full credit.

When? The conservation credits cover 2009 and 2010 only. The credits for generating energy are good through 2016. Any carryovers are good indefinitely.

Business Credits. The information here applies only to residential properties. There are credits for work done on business properties, but several rules are different. If you need help here, please call me.

Items To Watch

Once again I'll warn you - - '09, '10, and '11 have more law changes than any 3-year period in history, and more changes are likely. For now, to protect your own tax dollars, make up your mind to keep careful records. Here are some common areas where we've seen recent change. Be extra alert here to avoid surprises.

Separated Parents. The tax break for a youngster normally goes to the parent with greater time of custody. That parent is free to waive the deduction to the other parent. IRS collects less tax. The parents can choose to split the savings. Please remember – the custodial parent must sign an IRS waiver form, and we must attach this to the other parent's return. IRS demands the form, so talk this over between yourselves.

Capital Gains. For 2010 we still have low rates on long-term gains. Few experts expect to see these low rates in the future. This may be the year to align the portfolio.

Over 70½ IRA Distributions were voluntary in 2009. This year you must take at least a minimum distribution based on your age. Don't miss this one!

From IRA to Charity. If you were over 70½ in 2009, your IRA custodian could make a charitable gift directly from your IRA, reducing your taxes. This is expired. As of late July it has not been extended.

Roth IRA Conversions. Lots of talk here. In 2010 and on, anyone can convert IRA funds to a Roth IRA. You'll be taxed, but there's no penalty as long as you don't touch the money for 5 years. After the 5 years (and after you're 59½) the money's all tax-free. A very good thing! Convert as much or as little as you like, as long as you pay the tax. Many other rules apply, but remember – the transfer must happen by December 31, else it's an issue for 2011. Call me if you need help – *before* December 31!

Collect Unemployment? You may recall the first \$2,400 you got wasn't taxed in 2009. For 2010 *all* unemployment income is taxable.

Foreclosed? Loan Modified? The weak economy produced record numbers of "homeowners in trouble".

Looking For Work? Track All Expenses!

We are in the midst of record unemployment. I sincerely hope your own job is secure. When its time to look for another job, there might be some very valuable tax help available.

If You Itemize Deductions you may include job search costs. Probably no help for you if you use the standard deduction, currently \$5,700 for single filers, twice as much for couples. There's also a "floor" – your work-related deductions must exceed 2% of your gross income.

Same Occupation Requirement. Tax law looks at you as a producer within the economy. As long as your search is within the same general occupation, all costs count. A teacher can deduct costs to look for work in the field of education, but not to get a job as a welder.

Types Of Costs. Almost anything related to the search counts. Agency fees, costs to produce a resume, duplicating employment files, even a couple months' of your on-line fees if you use the computer in your search.

Travel vs. Transport. Within your metropolitan area, any driving is called "transport". Deduction – 50¢ for each mile you drive. Keep a log of interviews, meetings, trips for copying – it really adds up. "Travel" involves being "away from home overnight or longer". Now everything counts – fares, shuttles, hotels, meals – any out-of-town costs. For meals, there are allowances – probably easier than keeping records.

Be alert for anything. Even lunch with a friend who can provide a contact. I hope you find the right job quickly and easily. In the meantime I'd like to see you save every tax dollar the law allows.

If either happened to you, I'll need all possible information. History on the loan and payments, full facts on the actual events, everything. Any loan you did not fully satisfy can produce "income" if the debt was cancelled. There are ways to avoid the tax, but they are among the most complex of tax laws. With complete information, the reporting is tricky – without the information, it's impossible.

College Education. Special laws can provide up to \$2,500 per student in tax reductions. There are lots of rules. For safety, pay close attention to all tuition and fees, even if loans provide the funds. Also keep records on all costs for books and class supplies. In some cases, even graduate classes or job training count. If you have the information, I'll see to it you save every possible dollar.

If any costs are paid using a college savings plan, I'll need full records of costs and withdrawals.

Special Credits. Several things might produce big tax benefits:

Education is mentioned above.

Energy-Saving items are discussed on the previous page.

Hybrid Cars. If you bought a brand new hybrid, there *might* be a valuable credit. Toyota and Honda credits ran out in 2009. Ford had

reduced credits for 2010. Most other makes have credits available. For full details online, go to www.irs.gov and search "alternative motor vehicle credit". There are also some very generous credits for a very few of the new electric plug-in vehicles.

Child & Dependent Care.

These are alive and well. Besides the costs, be sure to get full ID from the provider, including telephone number and their "Tax ID" number.

Employers have some new tax breaks this year. I'll need complete information for new hires, as well as any long-time employees in your small business. If you provide health insurance, I'll need full details on the employees, payroll, and premiums.

Home Buyers. Special credits expired during 2010. If you bought a home, you heard about them. There are several documents we must attach to your return. Call me in advance.

Keep Good Records. 2010 and 2011 will be challenges for you and for me. Keeping track of all the law changes is one thing. Being able to find your information is another. Please set aside a place to keep any information that affects your taxes. It will be tough to dig this out at tax time unless you make the effort now. Yes, it's a chore, but remember – you'll be *paid* for the effort!

Tips For You

Youngster & Summer Jobs. If your child had that first summer job you may have questions. Will my youngster be taxed? Will my own tax be affected? Some facts, plus a couple of suggestions.

If the child won't reach age 19 in 2010 you still have a dependent. For ages 19-23, it depends on whether they are in school. The youngster may be taxed, but the tax is likely to be zero. The first \$5,700 earned is tax-free. We need to file a tax return if there is any withholding, but it is likely there will be a refund.

That refund. Why not try some financial training! A refund sounds appealing, but suggest the youngster open a Roth IRA. Not a big account, say \$200 or so from the refund. You might start a valuable savings habit!

Saving For College. Most parents (or grandparents) start to think about putting money aside for a youngsters' education. There are two different directions you might take.

Personal Accounts. Saving the money directly is one option. You'll need help with issues like custodial accounts, "in trust for" accounts, and the like. Or, you can consider:

Tax-Favored Accounts. These offer tax-free growth. The income is *never* taxed if spent on education. There are a couple of options.

ESA. Simplest is the Coverdell Education Savings Account (ESA).

The money in these accounts can be tapped as early as kindergarten. Many local banks and credit unions offer these. They're small – no more than \$2,000 annually for any child.

Section 529 Plans. These are administered for individual states and several universities. They only work for college and above. They offer similar tax benefits, but a little less control. Contribution limits are much higher than for the ESA.

Both Plans allow income to build up without tax. When money is withdrawn, even the growth is tax-free if the funds are spent on the proper education costs. In some cases excess funds can be moved to benefit another child. There are many other differences. For a clear and readable explanation, look at the website www.collegesavings.org. The big news – neither program generates kiddie tax problems.

Kiddie Tax & College Students. If your youngster is going to college, be on the lookout for investment income of \$1,900 or more for the student. This makes anyone under age 24 a "Kiddie" for income tax purposes. Congress set rules years ago to avoid wealthier families from "shifting" income to youngsters with lower tax brackets. The rules kick in at \$1,900 of "investment" income – interest, dividend, royalty, or capital gain items. They force the youngster to pay taxes at their own tax rates, or the parents', whichever is *higher*. If there is any chance this applies to

your child, please warn them not to file their own tax return. We need to finish your returns before theirs can be done correctly.

Extensions Expire October 15. A few of you still have not filed for 2009. Please make an effort to find the missing information. We have little time left. In most years I am not quite as busy this time of year. 2010 is very different! I expect to have more tax-planning work with clients who are confused over new rules. At the same time, I want to give my full attention to your return. I want to keep your taxes to the absolute minimum.

There are two systems of taxation in our country: one for the informed, and one for the uninformed.

Justice Leland Hand - U.S. Supreme Court

Your Tax Calendar

Sept. 15	3 rd quarter estimated tax payments due.
Oct. 15	Extensions to file 2009 Form 1040 expire.
Nov. 1	3 rd qtr. payroll returns due. (Nov. 10 if tax paid in full and on time.)
Dec. 31	Last chance for deductions in 2010.
Jan. 17	4 th quarter estimated tax payments due for 2010.

