

January 26, 2010

Greetings:

We apologize for being a little later this year with our letter. We were hoping to have information on any new taxes related to the health care legislation. Congress has continued to move away from tax simplification with a number of targeted taxes, deductions and credits. As a result, our checklist has expanded this year in order to address these changes. Below is a brief summary of the more significant Federal individual income tax changes.

CHANGES EFFECTIVE IN 2009

- ◆ There is a revised refundable tax credit for **first-time homebuyers**. The credit is the lesser of \$8,000 (\$4,000 for married, filing separately) or 10% of the purchase price. For homes purchased between January 1, 2009 and November 6, 2009, the credit is phased out between \$150,000 and \$170,000 of modified adjusted gross income for married taxpayers, and between \$75,000 and \$95,000 for all other taxpayers. For homes purchased between November 7, 2009 and April 30, 2010, the credit is phased out between \$225,000 and \$245,000 of modified adjusted gross income for married taxpayers, and between \$125,000 and \$145,000 for all other taxpayers. Unlike a credit available in 2008, there is no need to re-pay this credit in future years. However, the taxpayer could be required to repay the credit if the taxpayer stops using the residence as a principal residence within 36 months of the purchase settlement date. The taxpayer has the option of claiming this credit on the tax return for the year of purchase or amending their prior year income tax return. A “first-time homebuyer” is a taxpayer who has not owned a home for three years prior to the purchase. In the case of a married couple, if either spouse owned a home in the three prior years, the couple does not qualify. If you claimed the prior credit of \$7,500 on your 2008 return for a home purchased in 2009, you may be able to claim the larger credit (up to \$8,000) on an amended 2008 return. Transactions between related parties do not qualify.
- ◆ There is also a new refundable tax credit for **long-time residents of the same principal residence**. The credit is the lesser of \$6,500 (\$3,250 for married, filing separately) or 10% of the purchase price of a different principal residence. No credit is allowed if the purchase price exceeds \$800,000. The purchase must be settled between November 7, 2009 and June 30, 2010. The modified adjusted gross income limits listed in the section above for homes purchased between these dates and the 36 month usage requirements apply. The taxpayer (and spouse, if married) must have used the property as their principal residence for five consecutive years of the eight years prior to the purchase of the new principal residence. The taxpayer has the option of claiming this credit on the tax return for the year of purchase or amending their prior year income tax return. Transactions between related parties do not qualify.
- ◆ The personal energy property tax credit for **energy efficient improvements to your principal residence** returns after having expired at the end of 2007. This credit applies to insulation, exterior windows and doors, certain metal or asphalt roofs; certain electric heat pump water heaters, electric heat pumps, central air conditioners, and natural gas, propane, or oil furnaces; qualified furnace or hot water boiler that uses natural gas, propane or oil; a stove that burns biomass fuel to heat your home or to heat water for use in your home; and an advanced main air circulating fan used in a natural gas, propane or oil furnace. The credit is 30% of the cost up to a maximum credit of \$1,500. This credit is available in 2009 and 2010, but is limited to \$1,500 over the two year period.
- ◆ The residential energy efficient property credit applies to **solar energy systems, fuel cells, small wind energy systems and geothermal heat pumps**. This credit is calculated as 30% of the cost with no limit except in the case of fuel cells, where the credit limit is \$1,000 per kW of capacity.

- ◆ Owners of **vacation homes or second homes** can no longer benefit from two full primary home gain exclusions. Under the old rules, a primary residence could be sold and the gain excluded. Then the taxpayer(s) moved to the vacation home and lived there as their primary residence for two years, then sold the home and excluded the gain from tax. Under the new rules, the gain exclusion is prorated by the amount of time the owner actually uses the property as a primary residence over the amount of time that the property was owned.
- ◆ Any Pay-for-Performance Success Payments that reduce the principal balance of your home mortgage under the **Home Affordable Modification Program** are not taxable.
- ◆ There is a new tax credit called the **making work pay credit**. This credit is the lesser of 6.2% of your earned income (W-2 wages, self-employment earnings or nontaxable combat pay) or \$400 (\$800 for married filing jointly). The credit phases out between \$150,000 and \$190,000 for married taxpayers filing jointly, and between \$75,000 and \$95,000 for all other taxpayers. The credit is reduced by any payment received or credit claimed under the government retiree credit. It is also reduced by the \$250 economic recovery payment received in 2009 by recipients of Social Security, SSI, railroad benefits and Veteran's disability compensation or pension benefits.
- ◆ As mentioned above, there is a new tax credit called the **government retiree credit**. This is a credit for individuals who received a government pension or annuity payment for service performed for the U.S. government or any U.S. state or local government and the service was not covered by Social Security. The credit is a \$250 credit (\$500 if married filing jointly and both spouses receive a qualifying pension or annuity). However, it cannot be claimed if the taxpayer received a \$250 economic recovery payment during 2009.
- ◆ The **economic recovery payment of \$250** received in 2009 is not taxable for Federal income tax purposes, but it reduces the making work pay credit or the government retiree credit.
- ◆ The Hope credit for higher education costs is now replaced by the **American opportunity credit**. The maximum credit increases from \$1,800 to \$2,500, and part of the credit is now refundable. The credit is calculated as 100% of the first \$2,000 of tuition, fees and course materials, plus 25% of the next \$2,000. The credit is also expanded to cover four tax years rather than two.
- ◆ The cost of a **computer, software and internet access** that will be used while a student is enrolled is eligible for tax free distribution from a **qualified tuition plan** (Section 529 plan).
- ◆ In 2009, the first \$2,400 of **unemployment compensation** is exempt from tax.
- ◆ The 65% subsidy for payment of **COBRA health care coverage continuation premiums** is not taxable.
- ◆ The eligibility for a **deductible IRA contribution** for individuals covered by an employer retirement plan phases out between \$89,000 and \$109,000 for married filing jointly and qualifying widow(er)s, between \$55,000 and \$65,000 for single and head of household and between \$0 and \$10,000 for married filing separately. For spouses of taxpayers covered by a retirement plan, the eligibility phases out between \$166,000 and \$176,000 for married filing jointly and qualifying widow(er)s and between \$0 and \$10,000 for married filing separately.
- ◆ If you **purchased a new motor vehicle** between February 17, 2009 and December 31, 2009, you may be able to deduct the **sales or excise taxes** on the purchase. In states without a sales tax, you may be able to deduct certain other taxes or fees instead. This deduction is limited to the first \$49,500 of purchase price of the vehicle. The deduction phases out between \$250,000 and \$260,000 of modified adjusted gross income for married filing jointly and between \$125,000 and \$135,000 for all other filers. Eligible vehicles include passenger automobiles, motorcycles and light trucks under 8,500 pounds and motor homes.
- ◆ The **business mileage allowance** decreased from 58.5 cents to 55 cents per mile. The charitable mileage allowance remained at 14 cents, but the medical and moving mileage allowances decreased from 27 cents to 24 cents.
- ◆ Payments made under the CARS (**Cash for Clunkers**) program are not taxable.
- ◆ The **Section 179** expense deduction remains unchanged at \$250,000.
- ◆ Qualified assets placed in service in 2009 are eligible for 50% or 30% **bonus depreciation** in 2009.

- ◆ **Businesses** with \$15 million or less of gross receipts can elect to **carry back any loss arising in 2008** as far as five years in order to recover taxes paid prior to 2008.
- ◆ The Unified Credit Equivalent for **estate tax** increased to \$3,500,000, and the Unified Credit Equivalent for **gift tax** remained at \$1,000,000. Above these amounts, Federal estate and gift taxes apply. The top **estate and gift tax rate** remained at 45%.

CHANGES EFFECTIVE IN 2010

As we approach the end of 2010, keep in mind that the tax rates commonly referred to as the Bush tax cuts will automatically revert to the pre-Bush tax cut rates on January 1, 2011. To give you an idea of the change, below is a comparative table:

	<u>2009</u>	<u>2010</u>	<u>2011</u>
Tax rate brackets			
Top bracket	35%	35%	39.6%
Fifth bracket	33%	33%	36%
Fourth bracket	28%	28%	31%
Third bracket	25%	25%	28%
Second bracket	15%	15%	15%
Initial bracket	10%	10%	n/a
Child tax credit	\$1,000	\$1,000	\$500
AMT exemption			
Single	\$46,700	\$33,750	\$33,750
MFJ	\$70,950	\$45,000	\$45,000
Long term capital gains tax rate	15%	15%	20%
Qualified dividends maximum rate	15%	15%	39.6%
Estate tax			
Top rate	45%	0%	55%
Exemption amount	\$3.5 million	\$0	\$1 million
Gift tax			
Exemption amount	\$1 million	\$1 million	\$1 million

Everyone who pays taxes will experience a tax increase in 2011 as a result of the elimination of the 10% bracket. The full phase out of itemized deductions and personal exemptions for higher earning taxpayers also returns in 2011. In addition, there are currently proposals in Congress to increase or remove the upper limit for Social Security taxes, and to apply the Medicare tax of 2.9% to unearned income. Keep all of these changes and proposed changes in mind as you plan any income or deductions where you can control the timing. We believe that Congress will patch the 2010 alternative minimum tax problem as they have in each of the past few years. We also believe that investment values will decline further as the tax burden associated with income related to equity investments, and capital gains related to all investments, increases in 2011.

- ◆ Taxpayers aged 70 ½ or older are required to take minimum distributions from their IRAs and certain other retirement plans. The **required minimum distribution** rules were suspended for 2009. Minimum distributions are required again in 2010.
- ◆ Taxpayers can roll some or all their IRA money to a **Roth IRA** regardless of their adjusted gross income. In prior years, taxpayers whose AGI exceeded \$100,000 were prohibited from converting to a Roth. Anyone that rolls from a regular IRA to a Roth IRA must pay taxes on the amount of the conversion. If you own an IRA and your taxable income is low, you should consider converting some or all of the IRA to a Roth IRA in order to take advantage of your lower tax rate.
- ◆ Maximum earnings subject to **Social Security tax** remains unchanged at \$106,800.

- ◆ Maximum earnings to receive full **Social Security benefits** remains at \$14,160 for individuals under “Full Retirement Age.” Individuals can earn \$37,680 in the year that they attain FRA.
- ◆ The **estate tax** is repealed, and the Unified Credit Equivalent for **gift tax** remains at \$1,000,000. Above this amount, Federal gift taxes apply. The top **gift tax rate** remains at 45%.
- ◆ The **annual gift tax exclusion** remains at \$13,000. Payments of medical expenses or tuition made directly to the medical provider or to the school are not considered gifts for gift tax purposes. Also note that only the giver of the gift has reporting and tax responsibilities.
- ◆ The **business mileage allowance** decreases from 55 cents to 50 cents per mile, effective January 1, 2010. The charitable mileage allowance remains at 14 cents. The medical and moving mileage allowances decrease from 24 cents to 16.5 cents.
- ◆ The limit on **annual contributions to defined contribution plans** remains the lesser of \$49,000 or 100% of compensation. The compensation limit remains at \$245,000. The employer deduction is limited to 25% of aggregate compensation for all participants (20% of net self-employment income after self-employment tax deduction for self-employed).
- ◆ The following **tax benefits are scheduled to expire** and will not be available for 2010: deduction for educator expenses in figuring AGI; tuition and fees deduction in figuring AGI; increased standard deduction for real estate taxes; deduction for state and local sales or excise taxes on the purchase of a new motor vehicle; deduction for state and local sales taxes; the \$2,400 exclusion of unemployment benefits; the exclusion from income of qualified charitable distributions; and, the government retiree credit.
- ◆ **Contribution limits for IRAs and other retirement plans** as follows:

	<u>2009</u>	<u>2010</u>
Traditional & Roth IRA (under 50)	\$ 5,000	\$ 5,000
Traditional & Roth IRA (50 or older)	\$ 6,000	\$ 6,000
401(k), 403(b) & SARSEP (under 50)	\$16,500	\$16,500
401(k), 403(b) & SARSEP (50 & over)	\$22,000	\$22,000
SIMPLE (under 50)	\$11,500	\$11,500
SIMPLE (50 & over)	\$14,000	\$14,000

As of the date of this letter, our staffing consists of Diane Juergensen, CPA of Yardley, John Garrett of Langhorne and Maureen Austin of Langhorne.

If we prepared your tax return last year and you think it would be helpful, we can provide you with an organizer printout that lists your tax data from 2008 together with blank spaces to fill in your 2009 information. Just give us a call and ask for your organizer. When you have gathered your papers and information, call us at (215) 579-1260 for an appointment. Person-to-person interviews result in a better understanding of the information used in preparing your return, and they also result in better opportunities to identify tax savings for you. If you are experiencing financial difficulties, let us know. We look forward to seeing you again.

Robert H. McLaren

Theresa B. McLaren

McLaren & Co., P.C.
2009 Form 1040 Checklist

1. Check the **social security numbers** for yourself, your spouse and your dependents.
If
you have a new dependent, bring his or her name, birth date and social security number. If a dependent has died or ceased to be a full-time student, let us know.
2. Were you employed as an **employee**?
 - ◇ W-2 Forms (required to be mailed to you by January 31, 2010)
3. Did you earn **interest or dividends** from bank accounts, CDs, mutual funds, stocks or bonds not in an IRA or retirement plan?
 - ◇ Forms 1099-INT (required to be mailed to you by January 31, 2010, unless your financial institution receives an extension)
 - ◇ Forms 1099-DIV (required to be mailed to you by January 31, 2010, unless your financial institution receives an extension)
 - ◇ Forms 1099-OID (required to be mailed to you by January 31, 2010, unless your financial institution receives an extension)
 - ◇ Amount of tax exempt interest and dividends
 - ◇ Inserts from mutual funds showing amounts that are not taxable
4. Did you receive a **refund** of state or local income taxes?
 - ◇ Forms 1099-G (required to be mailed to you by January 31, 2010)
5. Did you receive or pay **alimony**?
 - ◇ Amount received or paid, social security number of payee
6. Were you employed as a **contractor**, or are you **self-employed**?
 - ◇ Forms 1099-MISC (required to be mailed to you by January 31, 2010)
 - ◇ Other income received not reported on Form 1099-MISC
 - ◇ Expenses paid by category
 - ◇ Inventory at December 31, 2009, if applicable
7. Did you **sell any stocks or bonds** not in an IRA or retirement plan?
 - ◇ Forms 1099-B (required to be mailed to you by January 31, 2010)
 - ◇ Date and amount of purchase
8. Did you **sell or exchange any mutual funds** not in an IRA or retirement plan?
 - ◇ Forms 1099-B (required to be mailed to you by January 31, 2010)
 - ◇ Dates and amounts of purchases
 - ◇ Annual statements showing dividends reinvested or statement from mutual fund showing average cost of shares sold
9. Did you have an interest in a **partnership, LLC, S corporation, trust or estate**?
 - ◇ Form(s) K-1

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10. Did you **sell any real estate** (other than your principal residence)?
 - ◇ Forms 1099-S (required to be mailed to you by January 31, 2010)
 - ◇ Settlement sheet from sale
 - ◇ Settlement sheet from purchase or estimate of purchase price and date purchased
 - ◇ Settlement sheets from refinancing
 - ◇ Estimates of improvements to property during ownership period

11. Did you receive a **distribution from an IRA, a Roth IRA, a pension or an annuity, or did you rollover, transfer, convert or recharacterize amounts?**
 - ◇ Forms 1099-R (required to be mailed to you by January 31, 2010)
 - ◇ The amount of any prior year after-tax IRA contributions

12. Did you have **rental property?**
 - ◇ Forms 1099-MISC (required to be mailed to you by January 31, 2010)
 - ◇ Other rental income not reported on Form 1099-MISC
 - ◇ Expenses of the rental property by category

13. Did you receive **unemployment compensation?**
 - ◇ Forms 1099-G (required to be mailed to you by January 31, 2010)

14. Did you receive **Social Security or Railroad Retirement benefits?**
 - ◇ Forms SSA-1099 or RRB-1099

15. Did you have any **gambling winnings?**
 - ◇ Forms W-2G (required to be mailed to you by January 31, 2010)
 - ◇ Amount of gambling losses

16. Are you an **Educator/Teacher?**
 - ◇ Amount of out-of-pocket costs for books, supplies, computer equipment, software, and other classroom materials

17. Did you incur certain business expenses as a **reservist, performing artist or fee-basis government official?**
 - ◇ Description and amount of each expense

18. Did you contribute to a **Health Savings Account?**
 - ◇ Form 1099-SA (required to be mailed to you by January 31, 2010)
 - ◇ Amount of contributions
 - ◇ Amount of your deductible

19. Did you make, or would you like to make, a **contribution to an IRA, a Roth IRA, a Keogh, a SEP or a SIMPLE retirement plan?**
 - ◇ Amount of contribution (We can calculate maximum for you if needed.)

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20. Did you pay **interest** on a **student loan**?
◇ Form 1098-E (required to be mailed to you by January 31, 2010)
21. Did you pay **tuition and fees for higher education** for yourself or your dependents?
◇ Form 1098-T (required to be mailed to you by January 31, 2010) or other evidence of courses taken, dates taken & amounts paid
22. Did you pay significant **medical expenses** relative to your income?
◇ Amounts paid for health insurance, long-term care insurance, nursing home costs, hospitalization, doctors, dentists, prescriptions, eye wear, lab & X-ray fees, medical equipment & supplies, and transportation for medical purposes
23. Did you pay **taxes**?
◇ Real estate taxes paid (if not reported on Form 1098 with mortgage interest)
◇ State and local income taxes paid
◇ Sales taxes paid on large purchases (motor vehicle, boat, etc.)
◇ Personal property taxes
24. Did you pay **mortgage interest** on a primary residence or second home, or **investment interest**?
◇ Forms 1098 (required to be mailed to you by January 31, 2010)
◇ Investment statements
25. Did you **acquire or refinance** a home or other property?
◇ Form 1098 and settlement sheet
26. Did you pay or accrue **mortgage insurance premiums** on the acquisition indebtedness on your personal residence?
◇ Amount of premiums paid or accrued
27. Did you make any **charitable contributions**?
◇ Amounts of contributions (You are required to have cancelled checks or to obtain receipts from the organization for contributions, but we do not need them to prepare the tax return.)
28. Did you have any **miscellaneous deductions**?
◇ Amounts for work clothes, tools, union & professional dues, professional subscriptions, job hunting expenses, unreimbursed employee business expenses, investment counsel and advisory fees, certain legal fees, safe deposit box rental
29. Did you use your leased **automobile** for business?
◇ Total, business and commuting miles for the year
◇ Amounts of insurance, repairs, gas & oil, registration, inspection, parking & tolls
◇ Date auto was leased, value of auto on lease date, lease payments

(over)

30. Did you use your owned **automobile** for business?
- ◇ Total, business and commuting miles for the year
 - ◇ Amounts of insurance, repairs, gas & oil, registration, inspection, parking & tolls
 - ◇ Amount of interest paid on automobile loan
 - ◇ Date auto was purchased and cost
31. Did you incur **child or dependent care expenses**?
- ◇ Name, address, taxpayer ID number of provider(s) and amount paid for each dependent
32. Did you purchase a **hybrid or other alternative-fuel vehicle**?
- ◇ Description of vehicle and date placed in service
33. Do you live in **Pennsylvania**?
- ◇ Name of your school district & municipality
 - ◇ Local earned income tax return
 - ◇ Amount contributed to Section 529 Tuition Savings Account
 - ◇ Amount contributed to a Health Savings Account or a Medical Savings Account
34. During 2009, did you live in **New Jersey** in rental property?
- ◇ Tax parcel number
35. Did you work in **New York**?
- ◇ Number of days worked inside & outside of New York City & state
36. Did you make **estimated Federal, state or local tax payments**?
- ◇ Dates & amounts
37. Did you receive an **Economic Stimulus payment** in 2009?
- ◇ Amount of your payment (while this is not taxable, it may affect other tax calculations)
38. Do you want any **refund deposited** to or **payment debited** from your bank account?
- ◇ Provide a canceled check (for bank routing and account numbers)
39. Did someone else prepare your **2008 income tax returns**?
- ◇ Copies of last filed year's Federal, state & local income tax returns
 - ◇ Tax preparation costs paid in 2009
 - ◇ Depreciation records for any assets carrying forward