

FEDERAL AND CALIFORNIA TAX UPDATE FOR TAX YEAR 2008

Personal exemption Amount. For tax year 2008, the personal exemption amount is \$3,500 (\$3,650 in tax year 2009).

Personal Exemption Amount Is Phased-Out Phased-Out. A five year phase-out of the personal exemption amount phase-out begins in tax year 2007. The reduction of the personal exemption amount will not exist for tax year 2010.

Phase-Out of Personal and Dependency Exemptions for Tax Year 2008.

	Phase-Out Begins When AGI Exceeds:	Phased-Out When AGI Exceeds:
Single	\$159,950	\$282,450
Married Filing Joint	\$239,950	\$362,450
Head of Household	\$199,950	\$322,450
Married Filing Separate	\$119,975	\$181,225

Uniform Definition of a Child Impacts Numerous Code Sections. Tax law contains five commonly used provisions that provide benefits to taxpayers with children:

1. The dependency exemption;
2. The child credit;
3. The earned income credit;
4. The dependent care credit; and
5. Head of household.

Qualifying Child Tests. A qualifying child must satisfy all four of the following tests:

- 1. Relationship.** The child is related to the taxpayer as follows: son, daughter, stepson, stepdaughter, or descendent of such a child, brother, sister, stepbrother, stepsister, of a descendent of such a relative, foster or adopted child. An eligible foster child is a child who is placed with the taxpayer by an authorized placement agency or by a decree issued by the courts. An eligible adopted child includes both a legally adopted child and a child legally placed for adoption.
- 2. Age.** The child must not have attained the age of 19 by the end of the calendar year or must be a student that has not attained the age of 24 by the end of the calendar year.
- 3. Principal Place of Abode.** The child must have the same principal place of abode of the taxpayer for more than half the year.
- 4. Support.** The child must not provide more than half of his or her own support for the

year.

5. Joint Return Restriction. Starting in 2009, the child must not have filed a joint return (other than to claim a refund only) with a spouse for any tax year beginning in the calendar year in which the taxpayer's tax year begins.

Definition of Qualifying Relative. Individuals not qualifying as a "qualifying child" may still be claimed as a dependent if four similar tests are satisfied.

1. Relationship. The individual must be:

- a. a child or a descendent of such a child;
- b. brother, sister, stepbrother, or stepsister;
- c. father, mother, or an ancestor of either;
- d. stepfather or stepmother;
- e. son or daughter of a brother or sister of the tax payer;
- f. brother or sister of the father or mother of the tax payer;
- g. son-in-law, daughter-in-law, father-in-law, mother-in-law, bother-in-law, or sister-in-law; or
- h. an individual that for the tax year has the same principal place of abode as the taxpayer and is a member of the taxpayer's household.

NOTE. These relationships do not include cousins.

2. Gross Income. The individual's gross income for the calendar year must be less than \$3,500 (in 2008).

3. Support. The tax payer must furnish over half of the dependent's total support for that calendar year.

4. Dependency. The individual must not be the qualifying child of the taxpayer or of any other taxpayer for the tax year.

Filing Requirements for Most Taxpayers. The filing requirements for most taxpayers are summarized in the following tables.

2008 Filing Requirements for Most Taxpayers

If your filing status is	And at the end of 2008 you were ...*	Then file a return if your gross income was at least ...**
Single	under 65	\$8,950
	65 or older	\$10,300
Married filing jointly ***	under 65 (both spouses)	\$17,900
	65 or older (one spouse)	\$18,950
	65 or older (both spouses)	\$20,000
Married filing separately	any age	\$3,500
Head of household	under 65	\$11,500
	65 or older	\$12,850
Qualifying widow(er) with dependent child	under 65	\$14,400
	65 or older	\$15,450

*If you were born on January 1, 1944, you are considered to be age 65 at the end of 2008

**Gross income means all income you received in the form of money, goods, property, and services that is not exempt from tax, including any income from sources outside the United States (even if you may exclude part or all of it). Do not include social security benefits unless you are married filing a separate return and you lived with your spouse at any time during 2008.

***If you did not live with your spouse at the end of 2008 (or on the date your spouse died) and your gross income was at least \$3,500, you must file a return regardless of your age.

Filing requirements for Dependents

If your parents (or someone else) can claim you as a dependent and any of the situations below apply to you, you must file a return.

In this table, earned income includes salaries, wages, tips, and professional fees. It also includes taxable scholarship and fellowship grants. Unearned income includes investment-type income such as taxable interest, ordinary dividends, and capital gain distributions. It also includes unemployment compensation, taxable social security benefits, pensions, annuities, and distributions of unearned income from a trust. Gross income is the total of your earned income and unearned income.

Single dependents - Were you either age 65 or older or blind?

No. You must file a return if any of the following apply.

1. Your unearned income was more than \$900.
2. Your earned income was more than \$5,450.
3. Your gross income was more than the larger of:
\$900, or
Your earned income (up to \$5,150) plus \$300.

Yes. You must file a return if any of the following apply.

1. Your unearned income was more than \$2,250 (\$3,600 if 65 or older and blind).
2. Your earned income was more than \$6,800 (\$8,150 if 65 or older and blind).
3. Your gross income was more than \$2,250 (\$3,600 if 65 or older and blind), or
Your earned income (up to \$5,150) plus \$1,650 (\$3,000 if 65 or older and blind).

Married Dependents - Were you either 65 or older or blind?

No. You must file a return if any of the following apply.

1. Your unearned income was more than \$900.
2. Your earned income was more than \$5,450.
3. Your gross income was at least \$5 and your spouse files a separate return and itemizes deductions
4. Your gross income was more than the larger of:
\$900, or
Your earned income (up to \$5,150) plus \$300.

Yes. You must file a return if any of the following apply.

1. Your unearned income was more than \$1,950 (\$3,000 if 65 or older and blind).
2. Your earned income was more than \$6,500 (\$7,550 if 65 or older and blind).
3. Your gross income was at least \$5 and your spouse files a separate return and itemizes deductions.
4. Your gross income was more than \$1,950 (\$3,000 if 65 or older and blind), or
Your earned income (up to \$5,150) plus \$1,350 (\$2,400 if 65 or older and blind).

CALIFORNIA FILING REQUIREMENTS

Individual Filing Requirements. The minimum filing requirements are shown below:

Filing Status	Age	California Gross Income			California AGI		
		Dependents			Dependents		
		0	1	2 or more	0	1	2 or more
Single or H O H	Under 65	14,845	25,145	32,870	11,876	22,176	29,901
Single or HOH	65 or older	19,795	27,520	33,700	16,826	24,551	30,731
Married/ RDP	Under 65 (both spouses/ RDPs)	29,690	39,990	47,715	23,752	34,052	41,777
Married/ RDP	65 or older (one spouse)	34,640	42,365	48,545	28,702	36,427	42,607
Married/ RDP	65 or older (both spouses)	39,590	47,315	53,495	33,652	41,377	47,557
Qualif. Widow or Widower	Under 65	N/A	25,145	32,870	N/A	22,176	29,901
Qualif. Widow or Widower	65 or older	N/A	27,520	33,700	N/A	24,551	30,731

STANDARD DEDUCTION AMOUNT INCREASED

The standard deduction for taxpayers who do not itemize deductions on Schedule A of Form 1040 is, in most cases, higher for 2008 than it was for 2007.

The basic standard deduction amounts for 2008 are:

Head of household - \$8,000

Married persons filing jointly and qualifying widow(ers) - \$10,900

Married taxpayers filing separately - \$5,450
Single - \$5,450

The standard deduction amount for an individual who may be claimed as a dependent by another taxpayer may not exceed the greater of \$900 or the sum of \$300 and the individual's earned income.

ADDITIONAL STANDARD DEDUCTION FOR REAL ESTATE TAXES. On the federal income tax return, you may claim an additional standard deduction for real estate taxes. This claim can be made if you do not itemize deductions. The additional real estate deduction is limited to \$500 (\$1,000 if married filing jointly).

A standard deduction worksheet is included at the end of this update.

The California standard deduction for tax year 2008 is as follows:

Single	\$3,692
Married/RDP filing joint	\$7,384
Married/RDP filing separate	\$3,692
Qualifying widow(er)	\$7,384
Head of household	\$7,384

California does not have an additional standard deduction for real estate taxes.

ADDITIONAL STANDARD DEDUCTION FOR NET DISASTER LOSS. If you do not itemize deductions, you can claim an additional standard deduction for any net disaster loss from a federally declared disaster. Your standard deduction is increased by any net disaster loss from a federally declared disaster that occurred in 2008. This amount is on Form 4684, line 18a.

If you are increasing your standard deduction by the amount of your net disaster loss, be sure to check the box on line 39c of Form 1040.

A standard deduction worksheet is included at the end of this update.

California does not have an additional standard deduction for net disaster loss.

FIRST-TIME HOMEBUYER CREDIT. In general, you can claim the credit if you are a first-time homebuyer. You are considered a first-time homebuyer if:

1. You bought your main home in the United States after April 8, 2008, and before July 1, 2009, and
2. You (and your spouse if married) did not own any other main home during the 3-year period ending on the date of purchase.

You cannot claim the credit if any of the following apply.

1. Your modified AGI is \$95,000 or more (\$170,000 or more if married filing jointly).
2. You are eligible to claim the District of Columbia first-time homebuyer credit for 2008 or any prior year.
3. Your home financing comes from tax-exempt mortgage revenue bonds.
4. You are a nonresident alien.
5. Your home is located outside the United States.
6. You sell the home, or it ceases to be your main home, before the end of 2008.
7. You acquired your home by gift or inheritance.
8. You acquired your home from a related party.

Generally, the credit is the smaller of:

1. \$7,500 (\$3,750 if married filing separately), or
2. 10% of the purchase price of the home.

You generally must repay (recapture) the credit over a 15-year period in 15 equal installments. The recapture period begins 2 years after the year in which you claimed the credit.

To take the credit, complete Form 5405 and attach it to your Form 1040. Include your credit on Form 1040, line 69.

NOTE: This is a refundable credit.

California does not have a first-time homebuyer credit.

COMBAT PAY ELECTION. The election to include nontaxable combat pay in earned income for figuring the earned income credit has been made permanent.

California does not have an earned income credit.

STANDARD MILEAGE RATES

For tax year 2008, the allowable deductions for the standard mileage rate are as follows:

Business miles. The standard mileage rate for the cost of operating your car for business use is 50.5 cents per mile (58.5 cents per mile after June 20, 2008).

Charitable services. The standard mileage rate allowed for use of your car when you use your car to provide charitable services to a charitable organization is 14 cents a mile.

Medical reasons. The standard mileage rate allowed for use of your car for medical reasons is 19 cents per mile (27 cents per mile after June 30, 2008).

Moving. The standard mileage rate for determining moving expenses is 19 cents per mile (27 cents per mile after June 30, 2008).

AMT EXEMPTION AMOUNT.

Alternative Minimum Tax. For tax year 2008, the AMT exemption amounts have been increased. The exemption amounts are:

- \$46,200 for single taxpayers and heads of household;
- \$69,950 for married couples filing jointly; and
- \$34,975 for married filing separately.

Alternative Minimum Tax Exemption Amounts. California’s AMT exemption amounts for tax year 2008 are:

- \$80,017 married filing jointly and surviving spouse;
- \$60,014 single and head of household; and
- \$40,007 married filing separate.

INTEREST AND DIVIDEND INCOME. Effective for taxable years before January 1, 2011, dividends will be taxed at the 0%/15% capital gain tax rate. This treatment applies for purposes of both the regular tax and the AMT.

The capital gain tax rates for tax years 2008 through 2011 are as follows:

Tax Bracket	2008 - 2010	2011
10% and 15%	0%	10%
25% and above	15%	20%

California has not conformed to this change.

EDUCATOR DEDUCTIONS. Deduction for educator expenses has been extended. through 2009.

California has not conformed; therefore, this deduction will increase California AGI.

IRA Deduction. The amount you, and your spouse if filing jointly, may be able to deduct as an IRA contribution will be \$5,000 (\$6,000 if age 50 or older at the end of 2008).

Roth IRAs. The 2008 contribution amount is \$5,000 (\$6,000 if age 50 or older at the end of 2008).

Elective Deferral Limitations. The dollar limit for 2008 on annual elective deferrals under 401(k), 403(b), salary reduction SEPs is \$15,500 and SIMPLES is \$10,500.

A Husband and Wife in Business Together. For taxable years beginning after December 31, 2006, The Small Business Tax Act generally permits a qualified joint venture whose only members are a husband and wife filing a joint return not to be treated as a partnership for federal tax purposes. All items of income, gain, loss, deductions and credits are divided between the spouses in accordance with their respective interest in the venture. Each spouse takes into account his or her respective share of these items as a sole proprietor on the appropriate form, such as Schedule C or F.

Limitation on Annual Depreciation for Automobiles. The maximum amount of depreciation that may be claimed on 100% business use luxury autos and trucks are:

Year 2008	Auto	Truck
1st year	\$2,960 (used) \$10,960 (new)	\$3,160 (used) \$11,160 (new)
2 nd year	\$4,800	\$5,100
3 rd year	\$2,850	\$3,050
4 th year	\$1,775	\$1,875
5 th year	\$1,775	\$1,875
6 th year	\$1,775	\$1,875
next year	\$1,775	\$1,875

Section 179 Deduction. For tax year 2008, the maximum section 179 deduction is \$250,000. The \$250,000 is reduced by the amount by which the cost of qualifying property placed in service during 2008 exceeds \$800,000.

For California purposes, the maximum Section 179 deduction remains at \$25,000. This allowance begins to be phased out when total assets placed in service exceeds \$200,000.

Foreclosures and Cancellation of Debt. The Mortgage Forgiveness Debt Relief Act of 2007 is a three-year exception for debt forgiveness on qualified home loans. This act excludes from taxation discharges of up to \$2 million of indebtedness that is secured by a principal residence and is incurred in the acquisition, construction or substantial improvement of the principal residence. This special relief is available for three years beginning January 1, 2007, and ending December 31, 2009.

Example. Taxpayer's principal residence is subject to a \$220,000 mortgage debt. The taxpayer's creditor forecloses in 2008. Due to declining real estate values, the residence is sold for \$180,000 later that year. Taxpayer has \$40,000 discharge of indebtedness income. Before the

new law, the \$40,000 would have been includible in the taxpayer's gross income.

Example. John and Alice purchased a home in 2005 for \$500,000. The original mortgage on the home was \$490,000, but they refinanced the property in January 2006 for \$525,000 of recourse debt. They used the \$35,000 to pay off their credit cards.

In August 2007, because they could not make their mortgage payments, the bank foreclosed on their home when the FMV was \$425,000.

They have \$100,000 of income from forgiveness of debt (\$525,000 - \$425,000).

For federal purposes, they may exclude \$65,000, which is the gain attributable to the acquisition debt (\$100,000 - \$35,000). The \$35,000 is not excludable.

For California purposes, the entire \$100,000 of debt relief is included in income.

The new laws debt forgiveness income exclusion does not apply to vacation homes or other second residences. The exclusion does not apply to taxpayers in Chapter 11 bankruptcy. Also, California has not conformed to this federal provision.

It is important to recognize the difference between nonrecourse debt (no personal liability) and recourse debt (personal liability). Under California law, a purchase money mortgage is nonrecourse debt. However, under federal law and California law, a refinance results in recourse debt.

CALIFORNIA TAX UPDATE FOR TAX YEAR 2008

Renter's Credit.

Single and married filing separate with California AGI of \$34,936 or less \$60 credit
Married filing joint, head of household, and surviving spouse
with California AGI of \$69,872 or less \$120 credit

Dividends and Capital Gains. For California purposes, dividends and capital gains are subject to the same rates as other income. There are no special rates for California.

Kiddie Tax. Federal law taxes kiddies under age 18 for 2008, and under age 24 for students in 2008, but California's age limit remains at age 14.

Health Savings Accounts (HSAs). California does not conform to HSAs. As such, contributions are not deductible, earnings are taxable and rollovers are subject to tax and may be subject to early distribution penalties.

Estimated Tax Threshold. AB 3078 increases the threshold for imposing the estimated tax

penalty from \$200 (\$100 if married/RDP filing separate) after subtracting withholding and credits to \$500 (\$250 if married/RDP filing separate).

This provision is effective on January 1, 2009, and specifically operative for taxable years beginning on or after January 1, 2009.

For taxable years beginning on or after January 1, 2009, the four required installments of estimated tax payments for individuals has been revised as follows:

1 st quarter installment	30% of estimated tax
2nd quarter installment	30% of estimated tax
3rd quarter installment	20% of estimated tax
4th quarter installment	20% of estimated tax

Changes To California Law On CTEC Exemption. Effective June 23, 2008, California Senate Bill 797 clarifies the definition of who is exempt, and who is not exempt from the requirement to register with the California Tax Education Council.

Employee exemption was based on the reasoning that the CP, EA, or attorney would review employees' work, and would sign the tax returns. However, recent CTEC visits to tax preparation offices have shown this is not always the case and many exempt-status employees are preparing and signing returns without any supervision. The newly revised law requires that all CPAs, EAs, and attorneys must sign the returns prepared by their exempt employees so that they are held fully accountable for the employees' work. If they prefer not to sign the return prepared by the employee, then the employee must register with CTEC so he or she can legally sign the return.

2008 STANDARD DEDUCTION WORKSHEET

Caution. If you are married filing a separate return and your spouse itemizes deductions, or if you are a dual-status alien, do not complete this worksheet. You cannot take the standard deduction even if you were born before January 2, 1944, are blind, pay real estate taxes, or have a net disaster loss.

1. Enter the amount shown below for your filing status.
 Single or married filing separately - \$5,450
 Married filing jointly or qualifying widow(er) - \$10,900
 Head of household - \$8,000 1. _____
2. Can you (or your spouse if filing jointly) be claimed as a dependent?
NO. Skip line 3, enter the amount from line 1 on line 4.
YES. Go to line 3.
3. Is your earned income more than \$600?
YES. Add \$300 to your earned income. Enter the total. 3. _____
NO. Enter \$900 on line 3.
4. Enter the smaller of line 1 or line 3 4. _____
5. If born before January 2, 1944, or blind, multiply the number on Form 1040, line 39a (or Form 1040A, line 23a) by \$1,050 (\$1,350 if single or head of household). Otherwise, enter -0- 5. _____
6. Enter any net disaster loss from Form 4684, line 18a. If more than zero, check the box on Form 1040, line 39c 6. _____
7. Enter the state and local real estate taxes you paid that would be deductible on Schedule A (Form 1040), line 6, if you were itemizing deductions. 7. _____
8. Enter \$500 (\$1,000 if married filing jointly) 8. _____
9. Enter the smaller of line 7 or line 8. If more than zero, check the box on Form 1040, line 39c (or Form 1040A, line 23c) 9. _____
10. Add lines 4, 5, 6, and 9. Enter the total here and on Form 1040, line 40 (or Form 1040A, line 24) 10. _____