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December 1, 2009

Re: 2010 Accountants' Memorandum

Happy Holidays from Miller, Kaplan, Arase & Co., LLP!

The 2009 year has seen big changes as the result of a new administration in Washington. New rules affect businesses and individuals not only with respect to the tax law, but also with regard to the workplace as a whole. Changes involve greater workplace safety protections, toughened anti-discrimination rules, union rights and greater enforcement of rules against unfair wage practices. As we go to press, the big battle over proposed health care reform is being fought. That may entail significantly more changes in our lives.

The *American Recovery and Reinvestment Act of 2009* was signed into law by President Obama on Feb. 17, 2009. It included an extension of bonus depreciation, established a longer timeline for net operating loss carry backs, offered temporary COBRA assistance as well as a greater incentive for first time home buyers. There is also a provision for a sales tax deduction on vehicle purchases and various energy efficiency credits. This was followed by the *Worker, Homeownership, and Business Assistance Act of 2009*, signed on Nov. 6, 2009 which extended and expanded the homebuyer credit still further.

Governor Schwarzenegger's latest budget increased personal income tax withholding, accelerated the installment payments for both corporations and individuals and conformed backup withholding at the 7% federal rate. The state is now actively pursuing businesses that fail to withhold on payments made to non-residents. The state has also created limited credit for hiring and for film production within the state.

In past years we have advised that if the IRS or the state have notified your business that taxes must be deposited electronically, you must do so or incur substantial penalties. California is now encouraging individuals to e-pay in anticipation of a mandatory requirement in this regard for future years. We have a short information brief on that as well as a selected few of the above mentioned items.

Finally, public health officials predict that worker absentee rates will increase over the next few months as the result of the flu. The Center for Disease Control has a website at www.flu.com that has pertinent information.

We look forward to serving you in 2010.

Miller, Kaplan, Arase & Co., LLP

MKA:sb

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I. EARNINGS REPORTS DUE IN 2010

A. Payroll Taxes1. IRS Form 941 - Employer's Quarterly Federal Tax Return

| | <u>2009 and 2010</u> |
|---|----------------------|
| <u>FICA:</u> | |
| <u>Social Security Wage Limit</u> | \$ 106,800.00 |
| Withholding Tax Rate ("OASDI" Portion Only) | 6.2% |
| Maximum Withholding | \$ 6,621.60 |
| Employer Matching Tax Rate ("OASDI" Only) | 6.2% |
| Maximum Employer Matching | \$ 6,621.60 |
| <u>Medicare Wage Limit</u> | Unlimited |
| Tax Rate ("HI" Portion Only) | 1.45% |
| Maximum Withholding | Unlimited |
| Employer Matching Tax Rate ("HI" Only) | 1.45% |
| Maximum Employer Matching | Unlimited |

In 2010, Form 941 is due as follows:

| <u>Quarter Ending Date</u> | <u>Form 941 Due Date</u> |
|----------------------------|--------------------------|
| December 31, 2009 | February 1, 2010 |
| March 31, 2010 | April 30, 2010 |
| June 30, 2010 | August 2, 2010 |
| September 30, 2010 | November 1, 2010 |

Depositing Taxes - Use Form 8109, Federal Tax Deposit Coupon, to make deposits unless you are required to deposit taxes electronically.

2. IRS Form 940 - Employer's Annual Federal Unemployment Tax Return

| | <u>2009 and 2010</u> |
|---|----------------------|
| Federal Unemployment Tax - On Annual | |
| Wage Limit of | \$ 7,000.00 |
| Federal Unemployment Tax Rate - Employer Only | 6.2% |
| Allowable California Credit | <u>5.4%</u> |
| Net Federal Tax Rate | <u>0.8%</u> |

File the Form 940 for the year ended December 31, 2009 by no later than February 1, 2010. Note: Deposits for 2009 were required for any quarter when the cumulative liability for the quarter was \$500.00 or more.

Special rules apply to family members working for another family member. In general, family members are exempt from federal unemployment insurance and, those under 18, from social security taxes. Federal income taxes are, however, required to be withheld. These special rules do not apply to family owned partnerships or corporations.

For California purposes, family employees are generally exempt from Unemployment Insurance (UI), Employment Training Tax (ETT), and State Disability Insurance (SDI). However, they are subject to personal income tax withholding.



I. EARNINGS REPORTS DUE IN 2010 (Continued)

A. Payroll Taxes (Continued)

3. California Forms DE 6 and DE 7

Employers must complete the fourth quarter 2009 Form DE 6, **Quarterly Wage Report**, and the 2009, Form DE 7, **Annual Reconciliation Return**. Both of these forms are due no later than February 1, 2010. Employers must file a DE 7 to reconcile the four quarterly Forms DE 6 and pay any unpaid taxes or request a refund of overpaid taxes for the year. Employers no longer file W-2 forms with the EDD; such information has been reported each quarter on the DE 6.

Additional Forms DE 6 are due in 2010 as follows:

| <u>Quarter Ending Date</u> | <u>Form DE 6 Due Date</u> |
|--------------------------------|-------------------------------|
| March 31, 2010 | April 30, 2010 |
| June 30, 2010 | August 2, 2010 |
| September 30, 2010 | November 1, 2010 |

The term "Subject Wages" means wages subject to employment taxes without consideration of the \$7,000 limitation. The term "PIT Wages" means wages subject to California personal income tax. When completing the Forms DE 6, enter each employee's subject wages in Box G and PIT Wages in Box H.

When preparing Form DE 7, you should enter the total subject wages for all employees on Line C. The amount on Line C should equal the total wages reported on the four quarterly Forms DE 6. Enter in Box D2 the total taxable wages subject to Unemployment Insurance (SUI) and Employment Training Tax (ETT). Do not enter more than \$7,000 for each employee. Enter in Box F2 the total taxable wages subject to disability insurance. Do not enter more than \$90,669 for each employee for the 2009 year.

Multiply the SUI, ETT, and Disability Insurance (SDI) rates by the applicable total taxable wages subject to each type of tax. List the total personal income tax withheld for all employees on Line G. Subtract payments made with Form DE 88, Report of Contributions, during the year. If there is a balance due, send the payment with Form DE 88. Do not send it with the DE 7.

A summary table is as follows:

| | <u>2010 Applicable During 2010</u> | <u>2009 Applicable During 2009</u> |
|---|--|--|
| SUI Tax - Annual Wage Limit (Tax Rate Assigned to Employers Based on Experience) | \$ 7,000.00 * | \$ 7,000.00 * |
| ETT - Annual Wage Limit Tax Rate | \$ 7,000.00 0.1% | \$ 7,000.00 0.1% |
| SDI Tax - Annual Wage Limit Tax Rate | \$ 93,316.00 1.1% | \$ 90,669.00 1.1% |
| Maximum Amounts to be Withheld | \$ 1,026.48 | \$ 997.36 |

* See Form DE 2088, notice of contribution rates and statement of UI reserve account mailed to all employers in December. If you need rate information, call the EDD Contribution Rate Group at (916) 653-7795. Employers have 60 days from the date of notification to dispute their UI contribution rate. The General EDD Telephone Assistance Line is (888) 745-3886.



I. EARNINGS REPORTS DUE IN 2010 (Continued)

B. Wage and Tax Statement - 2009 Form W-2 (Give to Employees before February 1, 2010)

| | | | | | | | | | | | | | |
|--|--|--|-----------------------------------|--|--------------------------------|---|--|----------------------------|--|---------------------|--|------------------|--|
| 22222 | | a Employee's social security number | | OMB No. 1545-0008 | | | | | | | | | |
| b Employer identification number (EIN) | | | 1 Wages, tips, other compensation | | 2 Federal income tax withheld | | | | | | | | |
| c Employer's name, address, and ZIP code | | | 3 Social security wages | | 4 Social security tax withheld | | | | | | | | |
| | | | 5 Medicare wages and tips | | 6 Medicare tax withheld | | | | | | | | |
| | | | 7 Social security tips | | 8 Allocated tips | | | | | | | | |
| d Control number | | | 9 Advance EIC payment | | 10 Dependent care benefits | | | | | | | | |
| e Employee's first name and initial | | Last name | | Suff. | | 11 Nonqualified plans | | | | | | | |
| f Employee's address and ZIP code | | 13 Statutory employee <input type="checkbox"/> | | Retirement plan <input type="checkbox"/> | | Third-party sick pay <input type="checkbox"/> | | 12a | | | | | |
| | | | | | | | | 12b | | | | | |
| | | | | | | | | 12c | | | | | |
| | | | | | | 12d | | | | | | | |
| 15 State | | Employer's state ID number | | 16 State wages, tips, etc. | | 17 State income tax | | 18 Local wages, tips, etc. | | 19 Local income tax | | 20 Locality name | |

Form **W-2** Wage and Tax Statement
 Copy 1—For State, City, or Local Tax Department

2009

Department of the Treasury—Internal Revenue Service

Notes Per 2009 Form Instructions:

- Military differential pay** - Payments made after 2008 to former employees while they are on active duty for more than 30 days in the Armed Forces or other uniformed services are now treated as wages. Report these payments in box 1 of Form W-2.
- Nonqualified deferred compensation plans** - Section 409A, added by the American Jobs Creation Act of 2004, provides that all amounts deferred under a nonqualified deferred compensation (NODC) plan for all taxable years are includible in gross income unless certain requirements are satisfied.

Additional Note:

S Corporation Fringe Benefits - An S corporation treats taxable fringe benefits paid on behalf of its 2% shareholder-employees as additional compensation to them. The corporation deducts the additional compensation on page 1, line 7 ("Compensation of officers") or line 8 ("Salaries and wages") of its Form 1120S. The corporation reports the additional compensation to the shareholder-employees on Forms W-2. The additional compensation is subject to federal tax withholding and is generally subject to employment taxes (FICA and FUTA). However, payments made pursuant to a plan providing accident and health coverage are only subject to income tax withholding; they are not subject to any other employment taxes.



I. EARNINGS REPORTS DUE IN 2010 (Continued)**B. Wage and Tax Statement - 2009 Form W-2 (Continued)****Notes: (Continued)**

3. **Qualified Transportation Fringe Benefits** - For 2010 up to \$230 per month of qualified parking (for 2009, it was also \$230) and up to \$230 per month of the combined value of transit passes and transportation by commuter highway vehicle may be excluded from gross income (for 2009, it was also \$230 per month as of February 17). Report any excess over the exclusion amount as wages in boxes 1, 3 and 5 of the employee's 2009 Form W-2. Note: Employers may also exclude \$20 per month paid to employees who commute to work by bicycle.
4. **Employer Provided Educational Assistance** - There is a personal income tax exclusion of up to \$5,250 for employees educational assistance programs annually.
5. **Deceased Employee's Wages** - The IRS has special instructions for reporting wages if an employee dies during the year. Consult the instructions to 2009 Form W-2.
6. **Group-Term Life Insurance** - You must include in your employees wages subject to social security and Medicare taxes the cost of group-term life insurance that is more than the cost of \$50,000 of coverage, reduced by the amount the employee paid toward the insurance. Report it as wages in boxes 1, 3, and 5 of the employee's 2009 Form W-2. Also, show it in box 12 with code C.

Figure the monthly cost of the insurance to include in the employee's wages by multiplying the number of thousands of dollars of insurance coverage over \$50,000 (figured to the nearest 10th) by the cost shown in the following table. Use the employee's age on the last day of the tax year. You must prorate the cost from the table if less than a full month of coverage is involved.

COST PER \$1,000 OF PROTECTION FOR ONE MONTH

| Age | Cost |
|--------------------|-------|
| Under 25..... | \$.05 |
| 25 through 29..... | .06 |
| 30 through 34..... | .08 |
| 35 through 39..... | .09 |
| 40 through 44..... | .10 |
| 45 through 49..... | .15 |
| 50 through 54..... | .23 |
| 55 through 59..... | .43 |
| 60 through 64..... | .66 |
| 65 through 69..... | 1.27 |
| 70 and older..... | 2.06 |

You figure the total cost to include in the employee's wages by multiplying the monthly cost by the number of full months coverage at that cost. For example, for a 50-year old employee with \$500,000 of group-term coverage, the total cost to include is \$1,242, as follows:

$$\$450 \text{ (insurance coverage over } \$50,000 \text{ in thousands of dollars)} \times .23 \text{ (cost per table)} \times 12 \text{ months} = \underline{\$1,242}$$

7. Selected notes for particular boxes follow:

Box b - Provide the Federal employer identification number (FEIN) assigned by the IRS. Do not use a prior FEIN once a FEIN is changed.

Box d - Control Number: This is optional. Employers may use this box to identify Forms W-2.



I. EARNINGS REPORTS DUE IN 2010 (Continued)**B. Wage and Tax Statement - 2009 Form W-2 (Continued)****Notes: (Continued)**

Box 3 – Social Security Wages: Cannot exceed \$106,800 for 2009.

Box 4 – Social Security Tax Withheld: Cannot exceed \$6,621.60 for 2009.

Box 5 – Medicare wages and tips: Unlimited for 2009.

Box 6 – Medicare tax withheld: Unlimited for 2009.

Box 11 – Show total distributions to the employee from a non-qualified deferred compensation plan or a Sec. 457 plan during 2009, here and in Box 1 (but not if reported in Boxes 3 or 5). Also include in Box 11 amounts under a nonqualified plan or a Sec. 457 plan that became taxable during the year for social security and medicare tax purposes, but were for services performed in a prior year. Payments to beneficiaries of deceased employees are reportable on Form 1099-R.

Box 12 – Enter a code (A through Z) codes for items such as cost of group term life insurance over \$50,000 (Code C), elective deferrals to a section 401(k) arrangement (Code D), etc. Do not enter more than four items in box 12. If more than four items are needed, use a separate W-2.

Box 13 – Checkboxes. Mark all checkboxes that apply.

- **Statutory Employees.** Mark this checkbox for statutory employees whose earnings are subject to social security and Medicare taxes but not subject to Federal income tax withholding. There are workers who are independent contractors under the common-law rules but are treated by statute as employees. They are called statutory employees.
- **Retirement Plan.** Mark this checkbox if the employee was an active participant (for any part of the year) in any pension plan.
- **Third-party sick pay.** Mark this checkbox only if you are a third-party sick pay payer filing a Form W-2 for an insured's employee.

Box 14 – Other. The lease value of a vehicle provided to your employee and reported in box 1 must be reported here or in a separate statement to your employee. You may also use this box for any other information you want to give your employee.

Boxes 15 through 20 – For State information. Enter in Box 19 the amount of SDI actually withheld, and in Box 20 the letters "CASDI". The 2009 SDI maximum was \$997.36.

C. Transmittal Form Addresses**The Following Form is Due by March 1, 2010:**

- **2009 Form W-3 (Federal)**

IRS Publication 393, entitled, "2009 Federal Employment Tax Forms," which was mailed to employers in November 2009, contains 2009 Form W-3 and specific instructions for completing that form. If you are required to file 250 or more Forms W-2, you must file them electronically, unless the IRS granted you a waiver. Otherwise see the mailing addresses on the following page.



I. EARNINGS REPORTS DUE IN 2010 (Continued)**C. Transmittal Form Addresses (Continued)**

File Copy A of Form W-2 with the entire first page of Form W-3 at the following address:

If Using United States Postal Service:

Social Security Administration
Data Operations Center
Wilkes-Barre, PA 18769-0001
**(For certified mail use Zip
Code 18769-0002)**

For Other IRS Approved Private Delivery Services:

Social Security Administration
Data Operations Center
Attn: W-2 Process
1150 E. Mountain Dr.
Wilkes-Barre, PA 18702-7997

The Following Form is Due No Later than February 1, 2010:**• 2009 Form DE 7 (California)**

File with the following address:

State of California
Employment Development Department
P.O. Box 826286
Sacramento, CA 94230-6286

D. Information Forms**1. IRS Form 1099 Series - U.S. Information Returns**

Generally, file for any individual, partnership or trust (non-corporate entity) to whom you paid rents, dividends, interests, commissions, fees, payments for services (not wages), etc. See the instructions to determine what type and amount of payments must be reported in the boxes and the correct type of Form 1099 to use.

Prepare in triplicate (no photocopies allowed); Copy A to be transmitted to IRS with Form 1096, a copy for the recipient and a copy for the employer's files. Give recipient their copy no later than February 1, 2010. Forms 1099 should be typed or machine printed, although for 2009 most Forms 1099 may now be furnished electronically to taxpayers with their consent. Please remember to include a telephone number below the address in the payer's section. A toll-free number has been implemented for IRS's Information Reporting Call Site. In response to requests from many employers, the new toll-free number is 866-455-7438.

2. IRS Form 1096 - Annual Summary and Transmittal U.S. Information Returns

Fill in name and address of payer. Indicate the number and type of Forms 1099 attached. Sign and mail to **Internal Revenue Service, Kansas City, Missouri 64999** (if company is located in California) before March 1, 2010. If not filed by the due date, significant penalties apply. If you file electronically, the due date is now March 31.

Filers and transmitters of information returns can obtain an extension of time to file by submitting a signed paper Form 8809, Request for Extension of Time to File Information Returns. The extensions are most often for a period of 30 days. Filers and transmitters may thereafter request an additional 30-day extension. The extensions apply only to filing with the government. The filer or transmitter must still provide statements to the recipients by the required due date.

If you are filing 250 or more returns of the same type, see IRS Publication 1220, Specifications for Filing Information Returns Electronically. The law requires such returns to be filed electronically.

Payees who file paper returns with the IRS must not send a paper copy to the California FTB; the IRS forwards the information to the FTB.



I. EARNINGS REPORTS DUE IN 2010 (Continued)

D. Information Forms (Continued)

3. Guide to Information Returns (If any date shown falls on a Saturday, Sunday, or legal holiday, the due date is the next business day.)

| Form | Title | What to Report | Amounts to Report | Due Date | |
|-----------------------------------|---|---|--|--------------|--|
| | | | | To IRS | To Recipient (unless indicated otherwise) |
| 1042-S | Foreign Person's U.S. Source Income Subject to Withholding | Income such as interest, dividends, royalties, pensions and annuities, etc., and amounts withheld under Chapter 3. Also, distributions of effectively connected income by publicly traded partnerships or nominees. | See form instructions | March 15 | March 15 |
| 1098 | Mortgage Interest Statement | Mortgage interest (including points) and certain mortgage insurance premiums you received in the course of your trade or business from individuals and reimbursements of overpaid interest. | \$600 or more | February 28* | (To Payer/ Borrower) January 31 |
| 1098-C | Contributions of Motor Vehicles, Boats, and Airplanes | Information regarding a donated motor vehicle, boat, or airplane. | Gross proceeds of more than \$500 | February 28* | (To Donor) 30 days from date of sale or contribution |
| 1098-E | Student Loan Interest Statement | Student loan interest received in the course of your trade or business. | \$600 or more | February 28* | January 31 |
| 1098-T | Tuition Statement | Qualified tuition and related expenses, reimbursements or refunds, and scholarships or grants (optional). | See instructions | February 28* | January 31 |
| 1099-A | Acquisition or Abandonment of Secured Property | Information about the acquisition or abandonment of property that is security for a debt for which you are the lender. | All amounts | February 28* | (To Borrower) January 31 |
| 1099-B | Proceeds From Broker and Barter Exchange Transactions | Sales or redemptions of securities, futures transactions, commodities, and barter exchange transactions. | All amounts | February 28* | February 15** |
| 1099-C | Cancellation of Debt | Cancellation of a debt owed to a financial institution, the Federal Government, a credit union, RTC, FDIC, NCUA, a military department, the U.S. Postal Service, the Postal Rate Commission, or any organization having a significant trade or business of lending money. | \$600 or more | February 28* | January 31 |
| 1099-CAP | Changes in Corporate Control and Capital Structure | Information about cash, stock, or other property from an acquisition of control or the substantial change in capital structure of a corporation. | Amounts of stock or property valued at \$100 million or more | February 28* | (To Shareholders) January 31 |
| 1099-DIV | Dividends and Distributions | Distributions, such as dividends, capital gain distributions, or nontaxable distributions, that were paid on stock and liquidation distributions. | \$10 or more, except \$600 or more for liquidations | February 28* | January 31** |
| 1099-G | Certain Government Payments | Unemployment compensation, state and local income tax refunds, agricultural payments, and taxable grants. | \$10 or more for refunds and unemployment | February 28* | January 31 |
| 1099-H | Health Coverage Tax Credit (HCTC) Advance Payments | Health insurance premiums paid on behalf of certain individuals. | All amounts | February 28* | January 31 |
| 1099-INT | Interest Income | Interest income. | \$10 or more (\$600 or more in some cases) | February 28* | January 31** |
| 1099-LTC | Long-Term Care and Accelerated Death Benefits | Payments under a long-term care insurance contract and accelerated death benefits paid under a life insurance contract or by a viatical settlement provider. | All amounts | February 28* | January 31 |
| 1099-MISC | Miscellaneous Income (Also, use to report direct sales of \$5,000 or more of consumer goods for resale.) | Rent or royalty payments; prizes and awards that are not for services, such as winnings on TV or radio shows. | \$600 or more, except \$10 or more for royalties | February 28* | January 31** |
| | | Payments to crew members by owners or operators of fishing boats including payments of proceeds from sale of catch. | All amounts | | |
| | | Section 409A income from nonqualified deferred compensation plans (NQDCs). | All amounts | | |
| | | Payments to a physician, physicians' corporation, or other supplier of health and medical services. Issued mainly by medical assistance programs or health and accident insurance plans. | \$600 or more | | |
| | | Payments for services performed for a trade or business by people not treated as its employees. Examples: fees to subcontractors or directors and golden parachute payments. | \$600 or more | | |
| | | Fish purchases paid in cash for resale. | \$600 or more | | |
| | | Crop insurance proceeds. | \$600 or more | | |
| | | Substitute dividends and tax-exempt interest payments reportable by brokers. | \$10 or more | | |
| Gross proceeds paid to attorneys. | \$600 or more | February 15** | | | |
| 1099-OID | Original Issue Discount | Original issue discount. | \$10 or more | February 28* | January 31** |
| 1099-PATR | Taxable Distributions Received From Cooperatives | Distributions from cooperatives passed through to their patrons including any domestic production activities deduction and certain pass-through credits. | \$10 or more | February 28* | January 31 |

*The due date is March 31 if filed electronically.

**The due date is March 15 for reporting by trustees and middlemen of WHFITs.

* Complete a separate Form 8865 for each foreign partnership for which you qualify under the categories of filers described in the form instructions. U.S. persons must also file Form 3520 to report certain transactions with foreign trusts and receipt of certain large gifts or bequests from foreign persons.



I. EARNINGS REPORTS DUE IN 2010 (Continued)

D. Information Forms (Continued)

3. Guide to Information Returns (Continued)

| Form | Title | What to Report | Amounts to Report | Due Date | |
|----------|---|--|--|-------------------------------------|--|
| | | | | To IRS | To Recipient (unless indicated otherwise) |
| 1099-Q | Payments From Qualified Education Programs (Under Sections 529 and 530) | Earnings from qualified tuition programs and Coverdell ESAs. | All amounts | February 28* | January 31 |
| 1099-R | Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. | Distributions from retirement or profit-sharing plans, any IRA, insurance contracts, and IRA recharacterizations. | \$10 or more | February 28* | January 31 |
| 1099-S | Proceeds From Real Estate Transactions | Gross proceeds from the sale or exchange of real estate and certain royalty payments. | Generally, \$600 or more | February 28* | February 15 |
| 1099-SA | Distributions From an HSA, Archer MSA, or Medicare Advantage MSA | Distributions from an HSA, Archer MSA, or Medicare Advantage MSA. | All amounts | February 28* | January 31 |
| 3921 | Exercise of an Incentive Stock Option Under Section 422(b) | Transfer of an employer's stock to an employee pursuant to the exercise of an incentive stock option under section 422(b). | All amounts | February 28* | January 31 |
| 3922 | Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c) | Transfer(s) of stock acquired through an employee stock purchase plan under section 423(c) | All amounts | February 28* | January 31 |
| 5498 | IRA Contribution Information | Contributions (including rollover contributions) to any individual retirement arrangement (IRA) including a SEP, SIMPLE, and Roth IRA; Roth conversions; IRA recharacterizations; and the fair market value (FMV) of the account. | All amounts | May 31 | (To Participant) For FMV/RMD Jan 31; For contributions, May 31 |
| 5498-ESA | Coverdell ESA Contribution Information | Contributions (including rollover contributions) to a Coverdell ESA. | All amounts | May 31 | April 30 |
| 5498-SA | HSA, Archer MSA, or Medicare Advantage MSA Information | Contributions to an HSA (including transfers and rollovers) or Archer MSA and the FMV of an HSA, Archer MSA, or Medicare Advantage MSA. | All amounts | May 31 | (To Participant) May 31 |
| W-2G | Certain Gambling Winnings | Gambling winnings from horse racing, dog racing, jai alai, lotteries, keno, bingo, slot machines, sweepstakes, wagering pools, poker tournaments, etc. | Generally, \$600 or more; \$1,200 or more from bingo or slot machines; \$1,500 or more from keno | February 28* | January 31 |
| W-2 | Wage and Tax Statement | Wages, tips, other compensation; social security, Medicare, withheld income taxes; and advance earned income credit (EIC) payments. Include bonuses, vacation allowances, severance pay, certain moving expense payments, some kinds of travel allowances, and third-party payments of sick pay. | See separate instructions | To SSA Last day of February* | To Recipient January 31 |

*The due date is March 31 if filed electronically.



I. EARNINGS REPORTS DUE IN 2010 (Continued)**E. Rules on 2009 Withholding from Supplemental Wage Payments****1. General Requirements**

The following discussion provides guidance on the proper way to withhold federal income tax from supplemental wage payments made in addition to regular wages.

Supplemental wages are compensation paid to an employee in addition to regular wages. Supplemental wage payments include bonuses, commissions, overtime pay, accumulated sick leave, severance pay, awards, prizes, back pay, retroactive wage increases for current employees, and payments for nondeductible moving expenses.

The payments may be made at a different time from regular wage payments, or may be based on a different wage rate or a different payroll period from regular wages, or on no particular payroll period at all. The supplemental withholding rate is generally 25%, effective retroactively to January 1, 2004 by federal law. Payments over \$1 million are subject to withholding at the highest tax rate, currently 35%.

You must decide whether to treat supplemental wage payments as regular wages or to separate them from regular wages before you withhold. The IRS provides computation rules that explain when supplemental wages must be included with regular wage payments and when they must be reported separately. The rules apply to supplemental payments made in the same calendar year that regular wages are paid.

The State of California now classifies supplemental and bonus payments into three categories for tax purposes as follows:

1. Regular Pay - All wages in the regular pay category are taxed based on the employee's W-4 in effect at the time the payment is made.
2. Supplemental Wages (such as overtime, severance pay and housing allowance) - The supplemental flat tax rate will be used if the payments are not paid with the employee's regular wages. If the payment is made with regular pay, the payment is taxed based on the employee's W-4; otherwise, the payment is taxed at the supplemental flat tax rate in effect at the time the payment is made, now 6.6% as of November 1, 2009.
3. Bonus Wages - The bonus flat tax rate will be used if the payments are not paid with the employee's regular wages. If the payment is made with regular pay, the payment is taxed based on the employee's W-4; otherwise the payment is taxed at the bonus flat rate in effect at the time the payment is made, currently 9.3%.

A payer is required to withhold on reportable payments, such as interest and dividends, under the following circumstances:

- a. The payee fails to furnish his TIN to the payor in the manner required;
- b. The IRS notifies the payor that the TIN furnished by the payee was incorrect;
- c. The IRS notifies the payor that backup withholding is required because the payee failed to properly report interest or dividends; or
- d. The payee fails to certify, under penalties of perjury, that the payee is not subject to backup withholding when such certification is required.



I. EARNINGS REPORTS DUE IN 2010 (Continued)**E. Rules on 2009 Withholding from Supplemental Wage Payments (Continued)****2. IRS Form 945 - Annual Return of Withheld Federal Income Tax**

Use this Form to report nonpayroll income tax withholding. These nonpayroll items include backup withholding and withholding on pensions, annuities, IRAs, and gambling winnings. Semi-weekly depositors are required to file Form 945-A, a summary of the tax liability, with their Forms 945.

Deposit withheld income tax (including backup withholding) with an authorized financial institution or the Federal Reserve Bank or branch that serves your area. Include Form 8109, Federal Tax Deposit Coupon. For 2009, File Form 945 no later than February 1, 2010.

If a taxpayer's total taxes for the year are less than \$2,500, the taxpayer is not required to make deposits, and can pay the taxes with the Form 945.

3. California Forms 592 and 597 - Returns for Tax Withheld at Source

Withholding agents must remit payments of tax withheld at source to the Franchise Tax Board by the required due dates in order to avoid interest assessments. Additionally, if Form 594, "Notice to Withhold Tax at Source" is issued by the California Franchise Tax Board, it must be completed as indicated in the instructions to that form. For 2009, the state has a new voucher that must be included with all payments.

F. Household Employee Taxes

If you pay a household employee cash wages of more than the amount specified by law in a tax year, \$1,700 in 2009 or 2010, you must withhold social security and Medicare taxes from all cash wages you pay to that employee. Unless you prefer to pay your employee's share of social security and Medicare taxes from your own funds, you should withhold a certain percentage set by law from each payment of cash wages. The specified dollar amount and percentages can be found under the topic "Do You Need To Pay Employment Taxes?" in Publication 926. Instead of paying this amount to your employee, pay it to the IRS with a matching amount for your share of the taxes. If you pay your employee's share of social security and Medicare taxes from your own funds, these amounts must be included in the employee's wage for income tax purposes. However, they are not counted as social security and Medicare wages or as Federal unemployment wages.

You are not required to withhold Federal income tax from wages you pay to a household employee. However, if your employee asks you to withhold Federal income tax and you agree, you will need Form W-4, Employee's Withholding Allowance Certificate, and Publication 15, (Circular E), Employer's Tax Guide, which has tax withholding tables.

If you withhold or pay social security and Medicare taxes, or withhold Federal income tax, you will need to file Form W-2, Wage and Tax Statement after the end of the year. You will also need a Form W-3, Transmittal of Wage and Tax Statement. To complete Form W-2 you will need both an employer identification number and your employee's social security number. If you do not already have an employer identification number (EIN), one can be requested by submitting Form SS-4 Application for Employer Identification Number.

If you paid cash wages to household employees totaling more than the specified dollar amount in any calendar quarter of the prior two years, you generally must pay Federal unemployment tax on a portion of the specified amount of cash wages you pay to each of your household employees in the current and following taxable years. For specific amounts look under the heading "Do You Need To Pay Employment Taxes?" in Publication 926.

If you must file Form W-2 or pay Federal unemployment tax, you will also need to file a Form 1040, Schedule H, Household Employment Taxes, after the end of the year with your individual income tax return.

For more information on withholding call FTB's Withhold at Source Unit at (916) 845-4900.



I. EARNINGS REPORTS DUE IN 2010 (Continued)**G. Penalties**

Withheld federal income taxes, social security and Medicare taxes along with certain excise taxes are called trust fund taxes. If trust fund taxes willfully aren't collected, not truthfully accounted for and paid, the IRS may charge a trust fund recovery penalty. The penalty is equal to the trust fund taxes evaded and may apply to a person or persons the IRS decides is responsible. Information return penalties (filing of W-2s, 1099s, etc.) fall into three categories, as follows:

1. Failure to File Correct Information Returns by Due Date:

The penalty applies to failing to file timely returns, failing to include all information required to be shown on a return, and including incorrect information on a return (including Taxpayer Identification Numbers). The penalty also applies for filing on paper when required to file on magnetic media, or failing to file paper forms that are machine readable.

The amount of the penalty is based on when the correct information is reported and ranges from \$15-\$50 per return up to a maximum of \$250,000 (\$100,000 for "small businesses").

2. Intentional Disregard of Filing Requirements:

The penalty is a minimum \$100 per information return with no maximum penalty.

3. Failure to Furnish Correct Payee Statements:

The penalty applies for failing to provide the statement by January 31, failing to include all information required to be shown on the statement or including incorrect information on the statement. The penalty is \$50 per statement, regardless of when the correct statement is furnished, with a maximum of \$100,000 per year. If the failure is due to intentional disregard of the rules, the penalty increases to a minimum of \$100 per statement with no maximum penalty.

Form 8809 can be used to request for extension of time to file information returns with the IRS. There are specific instructions that come with the form. If the instructions are not followed, the IRS can deny the extension request. The extension is only for 30 days but if more time is required, taxpayers can request an additional 30 days to file.

If the extension request is approved, it will only extend the date for filing the returns. It will not extend the due date for providing statements to recipients. Congress felt that it is more important to get the information to the recipients so they can start their tax returns, than to submit the information to the IRS.

California FTB assesses the same penalties as the IRS. The penalty amounts are the same, thus effectively doubling the IRS assessment rate.

Lastly, a \$50 penalty on corrective returns, such as the W-2c, will go into effect soon; however, no definite time has been established yet.



I. EARNINGS REPORTS DUE IN 2010 (Continued)**H. Electronic Federal Tax Payment System (EFTPS)**

Individuals, businesses, and tax professionals can now make a wide variety of payments via the Electronic Federal Tax Payment System (EFTPS) using the Internet or the phone. The new EFTPS initiative was launched in 2004 by way of an information release and the on-line release of a number of new IRS publications that explain the new system. IRS also launched a new on-line site devoted to EFTPS (www.eftps.com).

1. EFTPS for Businesses and Entities

A business may use EFTPS to make all federal tax payments, including income, estimated and excise taxes.

If aggregate federal tax deposits of a business exceed \$200,000 during a calendar year, it must use EFTPS beginning in the second succeeding calendar year. For example, if a business had more than \$200,000 in total deposits in 1999, it must have begun using EFTPS on January of 2001. Use of EFTPS by other businesses is voluntary.

A business can enroll for EFTPS on-line, or by completing Form 9779 (Business Enrollment Form) and mailing it to the EFTPS Enrollment Center. The enrollment steps (e.g., receipt of PIN and internet password) essentially are the same as they are for individuals.

Businesses (as well as other types of entities such as tax-exempts) have two choices: EFTPS-Direct and EFTPS-Through a Financial Institution.

2. EFTPS-Direct

A business that uses EFTPS-Direct may initiate electronic payments via EFTPS-Online, EFTPS-PC Software (supplied by IRS at no charge), or EFTPS-Phone. The three methods can be used interchangeably. Businesses use the same procedure for making EFTPS payments as individuals (see discussion above).

3. EFTPS-Through a Financial Institution

If its financial institution offers the service (for which it can levy a charge), a business may instruct it to electronically move funds from the business's account to the Treasury's. The tax payment must be initiated at least one day before payment is to be made. The tax payment must be made before the financial institution's ACH (Automated Clearing House) processing deadline. The financial institution then originates an ACH credit transaction to the Treasury's account, and the tax records of the business are updated at IRS.

Those businesses that use payroll companies are told to check with them for fees, deadlines and EFTPS enrollment instructions. Additionally, a business must enroll in EFTPS to initiate those tax payments not handled by its payroll company.

NOTE: On October 19, 2007, the IRS sent out a notice regarding its new EFTPS "batch provider" software that will be necessary to download in order to continue using the system. Before making payments, you need to register via the software at www.eftps.com/eftps/ext/hds/html. According to the IRS, the process takes about two weeks, so if this concerns you, we recommend that you download the User's Manual at the link above or contact the IRS at 1 (800) 945-0966.



II. AUTO MILEAGE AND EXPENSE REIMBURSEMENT INFORMATION

A. Employer Reimbursement Plan Rules

Reimbursements that do not meet IRS "accountable" standards must be reported as salary or wages on Form W-2. An employee is eligible to deduct the related expenses as miscellaneous itemized deductions subject to the 2% adjusted gross income and standard deduction limitations. If the reimbursements meet IRS rules, the plan is called "an accountable plan" and the reimbursements will generally not be reported on Form W-2. Under "an accountable plan" the employee may deduct otherwise allowable expenses which are in excess of the reimbursement as miscellaneous itemized deductions subject to various limitations previously stated.

B. Accountable Plan Defined

A reimbursement or other expense allowance arrangement constitutes an accountable plan if it has the following three elements:

1. The related expense has a business connection;
2. the employer requires the employee to substantiate the expenses; and
3. the employer requires the employee to return any amount paid in excess of the substantiated expenses.

We strongly recommend that the plan be in writing. If an arrangement meets the three main requirements of an accountable plan, but the employee fails to return the excess amount, only the amount that has been substantiated is treated as paid under an accountable plan. Special deemed substantiation rules apply to mileage allowances and meal and incidental per-diem expense allowances.

The requirements stated above are applied on an employee-by-employee basis. Failure by one employee to fulfill one of the criteria does not cause amounts paid to other employees under the arrangement to be treated as paid under a non-accountable plan. A payer may have more than one arrangement with a particular employee without running afoul of the accountable plan requirements.

Expenses subject to these rules include business meals, travel expenses, auto expenses and other similar expenses of the employee which are ordinary and necessary to the business of the employer and reimbursed to employees. Further, so called "expense allowances" are also covered. Expenses should clearly indicate what they are, the amount of each expense, date incurred, persons for whom the expense was incurred, place where expense was incurred and the business purpose of the expense. Certain expenses such as meals and entertainment require more information than automobile expenses.

Although advances remain a problem under the accountable plan rules, the IRS has provided a three-part test so that if all three parts are met, advances will not be treated as compensation. Part one of the test requires that an employer may not advance an employee monies earlier than 30 days before expenses are anticipated to be paid or incurred. Part two states that the employee must make adequate accounting for the expenses paid or incurred no later than 60 days after the expenses are paid or incurred. Finally all monies in excess of those properly accounted for as employee expenses must be returned within 120 days of paying or incurring such costs. If the first two parts of this test are met, but the excess monies are not returned within the 120 day period, only the excess must be treated as taxable compensation. If either of the first two parts are not met, the entire amount advanced is taxable compensation.

One major exception relates to per-diem type allowances. Here only the amounts received in excess of government allowances are treated as compensation and are subject to employment taxes and withholding. Other than not being required to verify actual costs incurred, employees using the per-diem method must still meet the same substantiation tests as with other reimbursement plans in order to avoid inclusion of the entire allowance as compensation subject to employment taxes and withholding.



II. AUTO MILEAGE AND EXPENSE REIMBURSEMENT INFORMATION (*Continued*)

C. IRS Automobile Reimbursement Mileage Rates

For 2009, you may elect to reimburse employees for substantiated business mileage at 55¢ for all business miles driven. This rate is used to calculate the tax deduction for business travel as an alternative to deducting actual costs of maintaining an automobile. The rate also is used by many companies to reimburse workers who use their own cars on company business.

The optional standard mileage rate for 2010 will be 50¢ per mile for business mile driven, the IRS says in a news release (December 3, 2009).

III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT

A. Taxation of Value of Automobile

Fringe Benefit Received in 2009

For 2009, vehicle use must be supported by the general substantiation rules that require a taxpayer to prove eligibility for, and the amount of, any deduction claimed for business use. Also, the taxable personal portion of vehicle use must be included in the "Employee Wage and Tax Statement" (Form W-2) with all applicable income and payroll taxes withheld from 2009 wages. It is mandatory to withhold payroll taxes and income taxes. In order to compute the taxable portion of vehicle use, the following should be done:

1. The employee should complete a "Summary Statement" (see sample copy attached) and submit this to the employer at the end of each calendar year.
2. The personal portion of vehicle use must be valued and included in fourth quarter 2009 payroll tax returns.
3. The employee's 2009 Form W-2 must include the taxable portion of vehicle use and related withholdings.

B. Employer Provided Vehicle

1. Exception for Commuting Use Only

There are several exceptions to the general vehicle substantiation rules. The commuting only exception may be used if all of the following five criteria are met:

- a. The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business and is actually used in that trade or business.
- b. For bona fide noncompensatory business reasons, the employer requires the employee to commute to and/or from work in the vehicle.
- c. The employer has established a policy that the vehicle may not be used for personal purposes other than commuting. Such policy must be in writing (an example of such written policy is attached) and be given to applicable employees (or posted).
- d. The employer reasonably believes that the employee does not use the vehicle for any purpose other than commuting except for de minimis personal use; and
- e. The employee required to use the vehicle for commuting is not a highly compensated "control employee" of the employer.



III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT *(Continued)*

B. Employer Provided Vehicle *(Continued)*

1. Exception for Commuting Use Only *(Continued)*

A control employee is any employee who meets any of the following:

- Is an appointed or elected officer whose compensation is \$50,000 or more.
- Is a director of the employer.
- Receives compensation of \$100,000 or more.
- Owns 1% or more equity, capital or profits interest in the employer.

Example A - Commuting Valuation Rule

Employee Y works for employer X. X provides a company vehicle to Y for the performance of Y's duties and requires Y to commute to and from work in the vehicle for noncompensatory but valid employer business purposes. X does not allow Y to use vehicle for any purpose other than that described and X reasonably believes that Y does not use the vehicle for other purposes. X has given Y a written policy statement and Y acknowledged receipt of policy in writing. Y is not a "control" employee.

Based on the information presented above, the five criteria necessary for the commuting only use exception are met. The taxable fringe benefit received would be calculated by multiplying \$3 times the total commuting days used by the employee. (A one-way commute would be valued at \$1.50) and:

- a. The employer must deduct all applicable payroll taxes and withhold income taxes from wages paid in the year that the benefit is received. (The withholding of income taxes, but not payroll taxes, can be waived at the employee's discretion.)
- b. The computed amount must be added to compensation records for that employee and included on Form W-2.
- c. The employee can reimburse the employer in January 2010 for all Social Security (FICA) and State Disability Insurance (SDI) required to be withheld if the employer was unable to timely withhold as stated in a.
- d. A payroll tax deposit for the above payroll taxes should generally be made no later than Monday January 4, 2010 for semiweekly depositors and on January 15, 2010 for monthly depositors. However, if total payroll taxes required to be deposited exceed \$100,000 for either type of depositor, then the deposit must be made by January 1, 2010.
- e. Be careful that the applicable payroll tax deposit is not underpaid.

2. Sample Notice to Employees When Using Commuting Use Only Exception

TO: (Employee)
 FROM: (Employer)
 DATE: _____
 RE: Employer-Provided Vehicle

We have elected to use a special valuation rule for 2009 in computing the value of personal use of the vehicle which has been assigned to you. The special rule will value personal use by an automobile lease valuation rule, vehicle cents-per-mile rule, or a commuting valuation rule. We will attempt to use the method (which is available to you) that results in the least amount of additional taxable income.



III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT (Continued)**B. Employer Provided Vehicle (Continued)****2. Sample Notice to Employees When Using Commuting Use Only Exception (Continued)**

In order to use the above special valuation rule, you must provide us with a written statement substantiating your personal use of the vehicle during 2009. This statement must include your total mileage for the year, broken down between business, commuting and other personal miles. Attached is a statement which should be used in substantiating the information to us.

In general, if you do not submit a written statement to us, the value of other personal use will be computed as if no portion of your driving was for business purposes.

Instructions to Employer

The above sample notice should state which of the three methods applies to the specific employee to which the notice is written. Any one of the methods may apply to any employee; thus an employer could have all three methods being utilized during the same calendar year.

3. Other Than Commuting Use Only

If one or more of the five criteria listed previously are not met, the following valuation methods, as described in examples B and C, may be used.

Example B - Vehicle Cents Per Mile

The value of any personal use by an employee of your vehicle may be calculated by multiplying the standard mileage rate (55¢ in 2009), by the number of miles driven by an employee for personal purposes, if you provide your employee with the use of a vehicle that either:

- you reasonably expect will be regularly used in your business throughout the calendar year (or a shorter period that the vehicle is owned or leased by you)
- is driven primarily by employees for at least 10,000 miles in a calendar year.

A vehicle is considered "regularly used" in an employer's business if either at least 50 percent of its total mileage for the year is for the employer's business or it is generally used each workday in an employer-sponsored car pool to transport at least three employees to and from work. You may not use the cents-per-mile rate unless the same or comparable vehicle could be leased on a cents-per-mile basis. Once the cents-per-mile rate has been adopted for a vehicle, you must continue to use that valuation method until the vehicle no longer qualifies.

For 2009, the cents-per-mile method can be used only for cars that had a fair market value of \$15,500 or less on the day they were first made available to an employee. This dollar amount is adjusted periodically to reflect inflation. For cars having a value in excess of that amount, the value of the availability of the car is to be determined under the general fair market value rule or the annual lease value method.

Maintenance and insurance are included in the standard mileage rate. However, no reduction in the rate is allowed if you do not provide these services. The rate also includes the fair market value of employer-provided fuel for miles driven in the United States, Canada, and Mexico. If fuel is not provided by you as the employer, the rate may be reduced by no more than 5.5 cents.



III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT (Continued)

B. Employer Provided Vehicle (Continued)

Example C - Automobile "Lease" Valuation Rule

Generally, you figure the annual lease value of an automobile as follows:

1. Determine the fair market value (FMV) of the automobile as of the first date the automobile is available for personal use.
2. Using the IRS Annual Lease Value Table, read down column 1 until you come to the dollar range within which the FMV of the automobile falls. Then read across to column 2 to find the corresponding annual lease value.

To obtain the ALV, the FMV of the vehicle must be determined as of the first day it was made available to the employee. In the fifth year that the auto is used, the FMV is redetermined and a new annual lease value is calculated from the table. That redetermined value is then used for the second four-year period.

Also, if the employer provides gas and oil, an additional taxable amount of 5-1/2¢ per mile of personal use must be added. The value of insurance, maintenance and repairs is included in the annual lease value table amount. Given an annual lease value of \$6,600 for a vehicle available all 365 days of the year and driven 5,000 personal and commuting miles out of 20,000 total miles, the taxable fringe benefit to be included as employee compensation would be calculated as follows:

| | | | | | | | |
|---------------------|--------------|---|-------------------|--------|------------------------|---|----------------|
| (1) Vehicle usage | | | | | | | |
| | \$6,600 | X | $\frac{365}{365}$ | X | $\frac{5,000}{20,000}$ | = | \$1,650 |
| (2) Gas and oil | | | | | | | |
| | 5,000 miles | X | | 5-1/2¢ | = | | <u>275</u> |
| | <u>Total</u> | | | | = | | <u>\$1,925</u> |

C. Employee Uses Own Vehicle

In this circumstance, the submission of the "Summary Statement" is crucial as will be explained in the following example.

If an employer elects to use the special valuation rules shown in Examples A through C, the employer must notify the employee of the election by the later of January 31 of the calendar year for which the election is to apply or 30 days after the employer first provides the benefit to the employee.

Example D

Employee D works for employer X. D drives a personal vehicle for the performance of D's duties on behalf of X. X provides 100% of the upkeep and maintenance (\$4,000) and D's Summary Statement indicates 25% personal use.

The taxable fringe benefit received would be calculated as follows:

1. The amount X has paid (\$4,000) times D's personal usage (25%).
 - (a) In this example, \$4,000 X 25% = \$1,000.
 - (b) Only the personal portion is included as additional income.
2. Follow procedures a through e as outlined in Example A.



III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT (Continued)

C. **Employee Uses Own Vehicle (Continued)**

Example D (Continued)

The above examples present the application of the special vehicle valuation regulations in a few generalized situations. It is not possible to cover all situations as the regulations covering valuation of employee fringe benefits are long and detailed. If you feel the above examples do not cover your specific situation, please contact the partner at Miller, Kaplan, Arase & Co., LLP in charge of your account for further guidance.

D. **Summary Statement**

Employee Name: _____

Social Security Number: _____

Employer: _____

Vehicle: _____

| | | | |
|------|-------|------|-----------|
| Make | Model | Year | ID Number |
|------|-------|------|-----------|

Period of Usage: From _____ to _____ (include month, date and year)

- Total miles driven for the period: _____
 - Total business miles driven for the period: _____
 - Total commuting miles driven for the period: _____
 - Total other personal miles (but not commuting miles) driven during the period: _____
 - Have you maintained sufficient evidence to support the business use?* Yes _____ No _____
 - Is the evidence written? Yes _____ No _____
 - Do you have another car available for personal use? Yes _____ No _____
- If yes, year, make and model _____

I hereby attest that the information listed above is true and correct to the best of my knowledge.

Employee

Date

*Note: Your records are not to be submitted with this statement to us; however, you are required to retain the supporting documents for a minimum of six years. The requirements for recordkeeping are solely your responsibility and not ours, as your employer. Please refer to IRS recordkeeping requirements if you have any questions.

E. **Policy Statement "Commuting Only Use" - Special Rule**

If an employer and employee elect to adopt the special rule ("Commuting Only Use"), a written policy must be established.

The policy could be worded as follows:

Employees who are provided with company owned automobiles must take those automobiles home at night to provide safe parking. Employees may not, however, use such automobile for personal purposes, other than for commuting or de minimis personal use.

III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT *(Continued)*

F. Annual Lease Value Table for Employer Provided Autos

The purpose of this table is to establish the annual value of personal use of employer provided autos. Take the table value times the personal use percentage. The product is the personal use value includable as additional wages subject to withholdings (including FICA and SDI).

| Automobile fair market value when first provided to employee | Annual lease value* |
|---|---------------------|
| \$ 0 to \$ 999..... | \$ 600 |
| 1,000 to 1,999..... | 850 |
| 2,000 to 2,999..... | 1,100 |
| 3,000 to 3,999..... | 1,350 |
| 4,000 to 4,999..... | 1,600 |
| 5,000 to 5,999..... | 1,850 |
| 6,000 to 6,999..... | 2,100 |
| 7,000 to 7,999..... | 2,350 |
| 8,000 to 8,999..... | 2,600 |
| 9,000 to 9,999..... | 2,850 |
| 10,000 to 10,999..... | 3,100 |
| 11,000 to 11,999..... | 3,350 |
| 12,000 to 12,999..... | 3,600 |
| 13,000 to 13,999..... | 3,850 |
| 14,000 to 14,999..... | 4,100 |
| 15,000 to 15,999..... | 4,350 |
| 16,000 to 16,999..... | 4,600 |
| 17,000 to 17,999..... | 4,850 |
| 18,000 to 18,999..... | 5,100 |
| 19,000 to 19,999..... | 5,350 |
| 20,000 to 20,999..... | 5,600 |
| 21,000 to 21,999..... | 5,850 |
| 22,000 to 22,999..... | 6,100 |
| 23,000 to 23,999..... | 6,350 |
| 24,000 to 24,999..... | 6,600 |
| 25,000 to 25,999..... | 6,850 |
| 26,000 to 27,999..... | 7,250 |
| 28,000 to 29,999..... | 7,750 |
| 30,000 to 31,999..... | 8,250 |
| 32,000 to 33,999..... | 8,750 |
| 34,000 to 35,999..... | 9,250 |
| 36,000 to 37,999..... | 9,750 |
| 38,000 to 39,999..... | 10,250 |
| 40,000 to 41,999..... | 10,750 |
| 42,000 to 43,999..... | 11,250 |
| 44,000 to 45,999..... | 11,750 |
| 46,000 to 47,999..... | 12,250 |
| 48,000 to 49,999..... | 12,750 |
| 50,000 to 51,999..... | 13,250 |
| 52,000 to 53,999..... | 13,750 |
| 54,000 to 55,999..... | 14,250 |
| 56,000 to 57,999..... | 14,750 |
| 58,000 to 59,999..... | 15,250 |

* Add 5.5 cents per mile for gas if reimbursed by employer.



IV. NEW LAWS

FEDERAL

A. Tax Break for Buying a New Vehicle

Under the American Recovery and Reinvestment Act of 2009 (ARRA), you can deduct the sales tax paid on up to \$49,500 of the cost of new vehicles bought by December 31, 2009. If you do not itemize, add sales tax on the vehicle to your federal standard deduction. If you do itemize and deduct state income taxes, you can deduct the sales tax in addition to your other itemized deductions. You may claim the write off on more than one vehicle, however, the deduction phases out for taxpayers with modified AGI between \$125,000 and \$135,000 (double that for a joint return.)

B. COBRA Continuation Coverage

As part of ARRA, the federal government gave people who lost their jobs in 2009 some assistance, by agreeing to pay a portion of their COBRA health insurance premium. COBRA (Consolidated Omnibus Budget Reconciliation Act of 1985) falls under a U.S. law that applies to employers and group health plans that cover 20 or more employees. As part of the tax package the federal government is paying 65% of the cost for nine months that lets people keep their health insurance when they leave a job. But unless extended, the program is set to end on December 31, 2009.

In May 2009, California enacted a COBRA subsidy for small employers which applies to employees who are involuntarily terminated from September 1, 2008 through December 31, 2009. Cal-COBRA applies to employers and group health plans that cover from two to 19 employees.

C. Credits for Energy Efficiency

The credits are detailed and itemized out at www.energystar.gov. The website has sub-categories of credits available for consumers, home builders and commercial buildings. To claim tax credits for energy efficient products placed into service in 2009, you will need to file Form 5695 and submit it with your 2009 tax return.

D. Bonus Depreciation

The 50% federal bonus depreciation has been extended one year to apply to property placed in service before January 1, 2010. There is no limit on the amount of bonus depreciation that can be claimed in any given year.

E. Withholding on Government Contracts

The date after which federal, state and local government entities are required to begin withholding three percent on certain payments or services and reporting the withheld amounts to the IRS is changed from December 31, 2010 to December 31, 2011.

F. First-Time Homebuyer Credit

The ARRA increased the amount of the credit to \$8,000 and extended availability through November 2009. The repayment provision was eliminated for purchases made after December 31, 2008. Taxpayers could elect to accelerate the benefit of the credit by treating a purchase made in 2009 as one having been made on December 31, 2008. Subsequently, the Worker, Homeownership, and Business Assistance Act of 2009 passed on November 6, 2009 extended the credit for those who have a binding contract in place before May 1, 2010. It increased the AGI phaseout threshold. It also established a credit up to \$6,500 for the purchase of a principal residence by an individual who has owned and maintained the same principal residence for any 5 consecutive years in the 8-year period preceding the purchase.

Members of the military and intelligence communities who are in service overseas on "official extended duty" for at least 90 days during 2009 and the first four months of 2010 have an extra year to take advantage of these credits. There are income based phase outs of these credits and other limiting factors, so for more information go to federalhousingtaxcredit.com, a website sponsored by the National Association of Home Builders.



IV. NEW LAWS (Continued)

FEDERAL (Continued)

G. Five Year Net Operating Loss Carryback

The new bill signed by the president on November 6, 2009 established a five-year carryback option for 2009 losses for most businesses, not just for small businesses as was established under ARRA. However, a net operating loss or loss from operations carried back five years can be used to offset no more than 50 percent of a taxpayer's taxable income in that fifth preceding year. This limitation does not apply to the fourth or third preceding year.

Taxpayers can elect the relief by attaching statements to their federal income tax returns for the taxable year in which the applicable NOL arises. Those who already have filed returns can attach the statements to their amended return for that taxable year, IRS said. Taxpayers must state they are electing to apply Section 172(b)(1)(H) or Section 810(b)(4) under Rev. Proc. 2009-52, and that they are not TARP recipients nor, in 2008 or 2009, an affiliate of a TARP recipient.

The statement also must specify the length of the NOL carryback period the taxpayer elects (three, four, or five years). Elections must be filed on or before the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009. A copy of the election statement also must be attached to the taxpayer's claim for tentative carryback adjustment (Form 1045, Application for Tentative Refund; or Form 1139, Corporation Application for Tentative Refund) or amended return applying the applicable NOL to the carryback year, IRS said.

H. E-Verify (Employment Eligibility) Program

E-Verify (formerly the Basic Pilot/Employment Eligibility Verification Program) is an online system operated jointly by the Department of Homeland Security and the Social Security Administration (SSA). Participating employers can check the employment eligibility of new hires online by comparing information from an employee's Form I-9, Employment Eligibility Verification, against SSA and Department of Homeland Security databases. More than 159,000 employers are enrolled in the program, with over 8.5 million queries run through the system in fiscal year 2009. There have been over 381,000 queries run through the system in fiscal year 2010 (as of October 12, 2009).

E-Verify is a voluntary program for most employers, but mandatory for some, such as employers with federal contracts or subcontracts that contain the Federal Acquisition Regulation (FAR) E-Verify clause and employers in certain states.

E-Verify is a voluntary program for employers, with limited exceptions. Companies can access E-Verify online and compare an employee's Form I-9 information with over 444 million records in the SSA database, and more than 60 million records in Department of Homeland Security immigration databases. E-Verify is an essential tool for employers committed to maintaining a legal workforce, and the number of registered employers is growing by over 1,200 per week.

Federal contractors and subcontractors are required to use E-Verify beginning September 8, 2009. Executive Order 12989 mandates the electronic verification of all employees working on any federal contract. The amended Executive Order reinforces the policy that the federal government supports a legal workforce.

To enroll, access www.dhs.gov, click on Information for Business. Go to Maintaining a Legal Workforce and follow the prompts. There is no charge for employers to use E-Verify.



IV. NEW LAWS (Continued)**FEDERAL (Continued)****I. Reporting Requirements for Incentive Stock Options**

Section 403 of the Tax Relief and Health Care Act of 2006 (Act) amended the information reporting requirements of section 6039. Prior to its amendment, section 6039 required corporations to furnish a written statement to each employee, in a manner prescribed by the Secretary in regulations, regarding: (i) the corporation's transfer of stock pursuant to the employee's exercise of an incentive stock option described in section 422(b); and (ii) the transfer of stock by the employee where the stock was acquired pursuant to the exercise of an option described in section 423(c). Corporations must furnish employees with the information statements required by section 6039 on or before January 31 of the year following the year for which the statement is required.

As amended by the Act, section 6039 now requires corporations to file an information return with the IRS, in addition to providing employees with an information statement, following a stock transfer. The time and manner for filing a return with the IRS, as well as the information to be contained in the return and furnished to employees, is addressed in these proposed regulations. Section 6039, as amended by the Act, applies to stock transfers occurring on or after January 1, 2007. However, the IRS waived reporting requirements for 2007 and 2008.

As we went to print, the IRS was still developing new Forms 3921 and 3922 along with the instructions to address the new reporting requirement, which may be delayed for another year.

J. New Form 941-X, Adjusted Quarterly Tax Return

The Internal Revenue Service (IRS) has developed Form 941-X, Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund, to replace Form 941c, Supporting Statement to Correct Information. Use Form 941-X to make corrections to previously filed Forms 941. Do not attach Form 941-X to Form 941; file Form 941-X separately.

Form 941-X replaces Form 843, Claim for Refund or Request for Abatement, for employers to request a refund or abatement of overreported employment taxes. Continue to use Form 843 when requesting a refund or abatement of assessed interest or penalties.

Use Form 941-X to correct errors on a Form 941 that you previously filed. Use Form 941-X to correct:

- Wages, tips, and other compensation;
- Income tax withheld from wages, tips, and other compensation;
- Taxable social security wages;
- Taxable social security tips;
- Taxable Medicare wages and tips;
- Advance earned income credit (EIC) payments made to employees; and
- Credits for COBRA premium assistance payments.

K. Genetic Information Nondiscrimination Act of 2008

"GINA" was enacted into law by congress in May 2008 and became effective in late November 2009. It prohibits employers from requesting genetic testing or considering someone's genetic background in hiring, firing or promotions.

The act also prohibits health insurers and group plans from obtaining such information to deny coverage or set premiums or deductibles. Some states already had similar laws, but according to the U.S. Department of Health and Human Services (HHS), most provisions were less protective than GINA.

GINA's provisions do not extend to life insurance, disability insurance or long-term care insurance. Consult the HHS at www.hhs.gov or your legal advisor if you have any questions.



IV. NEW LAWS (Continued)

FEDERAL (Continued)

L. Rules for Victims of Ponzi Schemes

We hope that none of our clients were victimized by Bernard Madoff or any of the other similar Ponzi schemes, but if so the IRS has issued guidance in the form of Rev. Ruling 2009-9 and Rev. Procedure 2009-20. Taxpayers who meet the tests of being a "Qualified investor" can take deductions as a theft loss not subject to the \$100 per occurrence deductible and 10% of AGI limitation. Instead the loss will be treated as a miscellaneous itemized deduction not subject to the 2% of AGI threshold.

The amount of the theft loss resulting from the Ponzi scheme is figured by taking the amount invested plus amounts reported as income, less any prior withdrawals, reimbursements and claims for which there is some chance of recovery. A qualified investor only includes persons who invested directly in a fraudulent scheme and does not include investors in "feeder funds".

M. AMT Refundable Credit

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 was enacted to provide relief to taxpayers who incurred alternative minimum tax liabilities (AMT) due to the exercise of incentive stock options (ISOs). The Act accelerates the abatement of any tax liability attributable to the requirement to include amounts in alternative minimum taxable income due to the exercise of an ISO for taxable years ending prior to January 1, 2008, as well as penalties and interest.

Prior legislation allowed taxpayers with long-term unused minimum tax credits, that is, unused minimum tax credits attributable to AMT liabilities for taxable years ending before the third taxable year prior to the current taxable year, to receive a minimum tax credit. This credit equaled at least 20% of the long-term unused minimum tax credits. The credit was subject to phase out based upon adjusted gross income. Further prior law did not provide relief from current year AMT liability.

The new Act allows 50% of such amounts to be used to reduce the tax liability or to create an overpayment for each tax year beginning before 2013. For 2008 and 2009, the credit is refundable if not otherwise allowable in reducing current tax liability.

CALIFORNIA

N. Estimated Tax and Withholding Changes

When Governor Schwarzenegger signed the latest state budget on July 28, 2009, in addition to the 10% increase in wage withholding for wages paid after October 31, 2009, there were two other provisions of note as follows:

- The law also increases the quarterly estimated tax payment scheme to 30%, 40%, 0% and 30%, respectively, applicable to installments due for each taxable year beginning after 2009.
- The state will now require payors to withhold 7% from specified reportable payments. This would generally conform to the federal backup withholding provisions. However, California's requirements would apply to rents, prizes and winnings, compensation for services, including bonuses, and other fixed or determinable annual or periodic gains, profits, and income, but would not apply to payments of interest and dividends or any release of loan funds made by a financial institution in the normal course of business. The California backup withholding provision would apply to payments made after 2009.

In 2009, the Governor vetoed a Federal conformity bill (AB 1580) meaning continued complexity of California return preparation for years to come. California has generally not conformed to any federal provisions enacted after December 31, 2004.



IV. NEW LAWS (Continued)

CALIFORNIA (Continued)

O. "Use Tax" Compliance Law

An Assembly Bill added section 6225 to the Revenue and Taxation Code, which requires a "qualified purchaser" to register with the Board of Equalization (BOE) and report and pay use tax directly to the BOE. Under this section, a "qualified purchaser" includes businesses with at least \$100,000 in annual gross receipts from business operations.

Generally, use tax applies when a person or business in California purchases tangible merchandise to be used, consumed, given away, or stored in this state from a retailer outside of this state who does not collect California tax on the sale. In simpler terms, if sales tax would apply when a particular item is purchased in California, use tax applies when a similar purchase is made from a retailer outside the state and no tax is charged. Use tax is not a new tax. It has been a part of the Revenue and Taxation Code since the 1930's. Only the registration requirement is new under AB x4-18.

A "qualified purchaser" means a person that meets all of the following conditions:

- The person receives at least \$100,000 in gross receipts from business operations per calendar year. Note: Gross receipts is the total of all receipts from both in-state and out-of-state business operations.
- The person is not required to hold a seller's permit or certificate of registration for use tax (under Section 6226 of the Revenue and Taxation Code).
- The person is not a holder of a use tax direct payment permit as described in Section 7051.3 of the Revenue and Taxation Code.
- The person is not otherwise registered with the BOE to report use tax.

A "qualified purchaser" may register for a use tax account by completing a Form BOE-404-A, *Use Tax Registration*, and mailing it to the BOE. While the BOE will attempt to notify qualified purchasers in order to register them, it remains the qualified purchaser's responsibility to register with the BOE.

The return for 2009, along with payment, is due by April 15, 2010.

P. Jobs Tax Credit

New Jobs Credit

There is a new California tax credit of \$3,000 for each additional full-time employee hired available to small businesses with 20 or less employees beginning January 1, 2009. The credit is not subject to the 50% limitation for business credits. The total amount of credit available to be claimed by all taxpayers is capped at \$400 million. The credit must be claimed on a timely filed original return received by the Franchise Tax Board on or before a cut-off date specified by the Franchise Tax Board. Taxpayers claiming the credit on an original return received by the Franchise Tax Board after the cut-off date is met will be notified that the credit has been denied. Taxpayers that have been denied the credit as a result of the \$400 million cap being reached will not be assessed an underpayment of estimated tax or underpayment of tax penalty to the extent the underpayment was created or increased by the disallowance of this credit.

An employer will qualify for the credit if:

- Each qualified full-time hourly employee is paid wages for not less than an average of 35 hours per week.
- Each qualified full-time employee that is a salaried employee was paid compensation during the year for full-time employment within the meaning of Section 515 of the Labor Code.
- On the last day of the preceding taxable year, they employed a total of 20 or fewer employees.
- There is a net increase in qualified full-time employees compared to the number of full-time employees employed in the preceding taxable year.
- For taxpayers who first commence doing business in California during the taxable year, the number of qualified full-time employees employed in the preceding year would be generally be zero, unless certain special rules apply.

Claim the credit on a 2009 Personal Income Tax or Business Entity Tax Return using the credit form for the New Jobs Credit.



IV. NEW LAWS (Continued)

CALIFORNIA (Continued)

Q. Film and Television Tax Credits

On February 20, 2009, Governor Arnold Schwarzenegger signed legislation creating tax credits for film and television productions. The California Film Commission (CFC) is administering the program and has provided detailed guidelines and other helpful information available through the website www.film.ca.gov.

The CFC receives and reviews applications. Prior to submitting an application, all applicants should review the guidelines, regulations and all required documents and forms to become familiar with the procedures. All applicants should consult with their legal and financial advisors regarding utilization of the tax credits.

The following is a brief description of the program parameters:

Qualified taxpayers are allowed a credit against income and/or sales and use taxes, based on qualified expenditures, for taxable years beginning on or after January 1, 2011. Credits applied to income tax liability are not refundable. Only tax credits issued to an "independent film" may be transferred or sold to an unrelated party. Other qualified taxpayers may carryover tax credits for 5 years and transfer tax credits to an affiliate.

To apply for the California Film and Television Incentive Program, a "qualified motion picture" must be one of the following:

(Eligible for 20% Tax Credit):

Feature Films (\$1 million minimum - \$75 million maximum production budget)

Movies of the Week or Miniseries (\$500,000 minimum production budget)

New television series licensed for original distribution on basic cable (\$1 million minimum budget; one-half hour shows and other exclusions apply)

(Eligible for 25% Tax Credit)

A television series, without regard to episode length, that filmed all of its prior seasons outside of California. An "independent film" (\$1 million - \$10 million budget that is produced by a company that is not publicly traded and that publicly traded companies do not own more than 25% of the producing company.)

A "qualified motion picture" must also meet the following conditions:

75% test (production days or total production budget) in California

Application must be submitted at least 30 days prior to commencement of principal photography

Once an application is approved, principal photography must begin within 180 days

How much was allocated to the program?

\$100 million annually beginning fiscal year 2009/2010 through fiscal year 2013/2014.

A minimum of \$10 million of the annual funding is available for independent films each year

Applications may be sent to the CFC offices via hand delivery, Fed Ex, UPS or other private mail service, U.S. Postal Service, or via messenger. Applications may **not** be faxed or sent electronically via e-mail.

Address:

California Film Commission
7080 Hollywood Blvd., Suite 900, Hollywood, CA 90028
Attn: California Film & Television Tax Credit Program



IV. NEW LAWS (Continued)

CALIFORNIA (Continued)

R. Required Electronic Payment for Individuals

On September 30, 2008, Governor Schwarzenegger signed Assembly Bill 1389, adding Section 19011.5 to the California Revenue and Taxation Code. This new law requires individuals to remit all future payments electronically once they: Make an estimated tax or extension payment (by check or electronic method) over \$20,000 for a taxable year beginning on or after January 1, 2009; or file an original return with a tax liability over \$80,000 for a taxable year beginning on or after January 1, 2009. Fiduciaries, estates, and trusts are not required to make payments electronically, regardless of the amount owed.

On December 1, 2008, the FTB sent courtesy letters to taxpayers who made an estimated tax payment in 2008 that was near or above the new mandatory e-pay threshold amount (\$20,000). The letter informed these taxpayers of the law change, and that they may meet the requirement for mandatory e-pay in 2009. **However, in November 2009, the state announced that they will not impose a penalty in this regard in 2010.** If you are affected by this requirement you need to review the instructions for Web pay on the state website at www.ftb.ca.gov.

If you make a payment or file a return meeting the mandatory requirement, the state will send you an FTB 4106 MEO, Mandatory e-pay Participation Notice, advising you that all future payments must be remitted electronically. **NOTE:** If you do not receive notification from the FTB, you are still required to remit payments electronically once you meet either of the above thresholds. Some tax preparation software may also remind you to e-pay. If your tax preparation software generates paper Form 540-ES vouchers when you meet the mandatory e-pay threshold, you must still pay electronically.

Once you meet the mandatory e-pay threshold, you will be required to make all subsequent payments electronically, regardless of the amount, type, or taxable year. **For example:** You make your first quarter estimated tax payment of \$25,000 on 4/15/09 by paper check. Any payment made after that (for example, a bill payment from a previous year or your second quarter estimated tax payment) must be made electronically. When you are required to make electronic payments but pay by other means, the state can assess a penalty equal to 1 percent of the amount paid, unless your failure to pay electronically was for reasonable cause and not willful neglect.

S. Withholding on Payments Made to Non-Residents

California law requires businesses to withhold on payments made to non-resident independent contractors for services rendered in state. Additionally, flow through entities such as partnerships and S-Corporations must withhold on distributions of current income to non-resident partners and shareholders. Historically the Franchise Tax Board (FTB) has not fully enforced the requirement, but supposedly they are now actively pursuing businesses in this regard.

Should the FTB find that a business has not complied with the requirement, they will assess the 7% withholding liability against the business plus penalties. See FTB Form 592-B. The IRS also has withholding requirements with respect to payments made to foreigners.

CITY OF LOS ANGELES

T. Information for City of L.A. Landlords and Tenants

Effective August 16, 2009, landlords who rent properties subject to the City of Los Angeles Rent Stabilization Ordinance must post a notice providing information about the Rent Stabilization Ordinance, as well as contact information for the Los Angeles Housing Department. The notice must be given in a LAHD form and be posted in a conspicuous location in the lobby of the property, near a mailbox used by residents of the property, or in or near a public entrance to the property. The notice must be written in English and Spanish and in any other languages required by the Los Angeles Housing Department (LAHD).



IV. NEW LAWS (Continued)**CITY OF LOS ANGELES (Continued)****T. Information for City of L.A. Landlords and Tenants (Continued)**

LAHD will inspect properties and notify property owners who fail to post the required notice. Landlords have 7 days to comply by posting the required notice. If the landlord fails to comply, a fine of \$250 per day may be charged after the seventh day that the landlord has failed to post the required notice. The amendment to the Rent Stabilization Ordinance requiring the posting of notice for RSO properties was adopted by Ordinance No. 180769. For additional information, please contact the LAHD Customer Service Hotline at (866) 557-7368.

VI. CALIFORNIA INDEPENDENT CONTRACTOR REPORTING REQUIREMENTS**A. Independent Contractor Reporting Requirements**

In an effort to increase child support collection by helping to locate parents who are delinquent in their child support obligation, California State Senate Bill 542 was passed during the 1999-2001 legislative session and signed into law. This law, effective January 1, 2001, requires businesses and government entities to report specified information to the Employment Development Department (EDD) on independent contractors.

Who Must Report

Any business or government entity (defined as a "service-recipient") that is required to file a federal Form 1099-MISC for services performed by an independent contractor (defined as a "service-provider") must report. A service-recipient means any individual, person, corporation, association, or partnership, or agent thereof, doing business in this State, deriving trade or business income from sources within this State, or in any manner in the course of trade or business subject to the laws of this State. An independent contractor is defined as an individual who is not an employee of the business or government entity for California purposes and who receives compensation or executes a contract for services performed for that business or government entity either in or outside of California.

B. When Must the Information Be Reported

You must report to EDD within twenty (20) days of EITHER making payments totaling \$600 or more OR entering into a contract for \$600 or more with an independent contractor in any calendar year, whichever is earlier.

C. What Information Must Be Reported

You are required to provide the name of your business, the Federal employer identification number, California employer account number, social security number, address and telephone number.

You are also required to provide independent contractor's (service-provider's) first name, middle initial, last name, social security number, address and start date of contract, along with the amount of contract, contract expiration date, and an indication if an ongoing contract (check box if applicable).

D. General Information

Report independent contractor information on the *Report of Independent Contractors* form (DE 542). To obtain forms and/or information, call (916) 657-0529. You may also contact your local [Employment Tax Customer Service Office](#) listed in your local telephone directory in the State Government section under "Employment Development Department" or access the Internet site at www.edd.ca.gov. For magnetic media filing, please call (916) 651-6945.



VII. EARNED INCOME CREDIT

The law continues to require employers to notify employees of their eligibility for the advance payment of the Earned Income Credit (EIC) through payroll. The EIC is a tax credit available to certain low income workers *even though no income tax withholding is required on their wages*. Eligible employees may elect to receive EIC through reduced federal income tax withholding (or negative federal income tax withholding) throughout the year rather than waiting to claim it on an income tax return. An employee makes the election by submitting a completed Form W-5, Earned Income Credit Advance Payment Certificate, with the employer.

The Form W-5 eligibility certificate verifies to the employer that (1) the employee is eligible for the EIC, (2) the employee has one or more qualifying children, (3) the employee has no other certificate in effect with another employer, and (4) states whether the employee's spouse has an eligibility certificate in effect. Even though persons without children are eligible for the EIC, they are not eligible for the advance payments of EIC. The election can be revoked or modified any time the individual's circumstances change. A new Form W-5 is required for each year the election is in effect. For 2008, if compensation or AGI exceeded \$33,995 for a single taxpayer (\$36,995 if filing a joint return) with one child; \$38,646 (\$41,646 if filing a joint return) with more than one child, advance EIC payments must have ceased. Publication 596 contains detailed information including any inflation dollar adjustments to the above referenced amounts.

VIII. PAYROLL TAX DEPOSIT SYSTEM

All employers are either federal "monthly depositors" or "semi-weekly depositors". The IRS notifies taxpayers of their status prior to the beginning of each calendar year. Status is determined by reference to the employer's deposit history during a "lookback period." The lookback period for a given calendar year is the 12-month period ending the preceding June 30.

An employer is a monthly depositor for a calendar year if the aggregate amount of employment taxes reported on its quarterly returns, Forms 941, for the four consecutive quarters ended the preceding June 30 is \$50,000 or less. An employer is a semi-weekly depositor if the aggregate is more than \$50,000. Initially, new employers are treated as monthly depositors. A monthly depositor must deposit employment taxes accumulated within the calendar month by the 15th day of the following month. For a semi-weekly depositor, if the depositor's payday is on a Wednesday, Thursday or Friday, taxes must be deposited on or before the following Wednesday. For all other paydays, the deposit is due on the Friday following payday. A special one-day rule applies to any employer which has more than \$100,000 undeposited employment taxes.

The deposit timetable is extended to the immediate next banking day when the deposit obligation falls on a non-banking day. Semi-weekly depositors have additional relief; they have a minimum of three banking days after the end of the semi-weekly period to deposit their taxes. Thus, a semi-weekly depositor with a Friday payroll will have until the following Thursday to deposit employment taxes if the Monday, Tuesday or Wednesday following the payday is a banking holiday.

An employer is treated as having made the required deposit if any shortfall does not exceed the greater of \$100 or two percent of the amount required to be deposited and the shortfall is deposited on or before prescribed make-up dates. For a monthly depositor, the shortfall make-up date is the return due date for the return period in which the shortfall occurs. For a semi-weekly depositor, the shortfall make-up date is the first Wednesday or Friday (whichever is earlier) falling on or after the 15th day of the month in which the deposit must be made.

IX. EMPLOYEE OR INDEPENDENT CONTRACTOR

Many companies have attempted to avoid taxes by calling their workers independent contractors when in fact they were really employees. The state and federal taxing authorities have been auditing companies to find such abuses. The following is an updated and edited list of factors from the IRS' approach to worker classification. These factors should be considered general guidelines. Certain factors carry more weight than others depending upon specific industry practices.

After 1996, the IRS has the burden of proof on classification of workers if the taxpayer can cite judicial precedent or long-standing industry practice for not treating a worker as an employee. Filing Forms 1099-MISC consistent with the taxpayer's treatment of a worker as a non-employee is imperative.



IX. EMPLOYEE OR INDEPENDENT CONTRACTOR (Continued)

The IRS is developing criteria on an industry-by-industry basis as to which factors weigh more heavily than others and which should not be applied at all. Even though the new law has placed more responsibility on the IRS to substantiate that independent contractors are employees, we believe that based on the success that the IRS has obtained in its audits on the independent contractor issue, they will continue and intensify their industry classification projects.

A. Worker Classification: The IRS' Approach**1. Do behavioral controls over the worker exist?**

Behavioral control focuses on whether the business has the right to direct or control how the work is done, e.g. how the worker performs the specific task for which he was hired. Factors include:

- a. To what extent are instructions given and taken?
- b. What training does the business give the worker?

2. Do financial controls over the worker exist?

These factors illustrate whether there is a right to control how the business aspects of the worker's activities are conducted:

- c. Can the worker realize a profit or incur a loss?
- d. Is the worker's investment significant?
- e. To what extent does the worker make services available to the general public?
- f. How does the business pay the worker?

3. What type of relationship between the parties exists?

These factors illustrate how the worker and the business perceive their relationship.

- g. Does a written contract exist that describes the relationship the parties intend to create?
- h. Does the business provide the worker with employee-type benefits?
- i. How permanent and ongoing is this relationship?
- j. To what extent are the services performed by the worker a key aspect of the regular business of the company?

B. Factors the IRS Now Considers of Lesser Importance

The IRS de-emphasized its focus on several other factors that were previously used in the old 20-factor test, including:

1. Does the client/customer have the right to discharge the worker?
2. Does the worker have the right to terminate the relationship?
3. Can the worker work part time or is full time required?
4. Must the work be performed on the employer's premises?
5. Who sets the hours to be worked?
6. Must the work be performed in an order or sequence?

Federal law and California law are not the same. California puts less emphasis on common industry practices.



X. REPORTING OF CASH TRANSACTIONS IN EXCESS OF \$10,000

If your business receives \$10,000 in cash in one transaction or two or more related transactions in a 24-hour period you must file federal Form 8300. In addition, this form may voluntarily be filed for any suspicious transaction, even if it does not exceed \$10,000. The term cash includes a cashier's check, bank draft, travelers check and money order. The civil penalties for failure to comply with the filing and payer reporting requirements are the same as those for failure to file or correctly file Forms 1099. Criminal penalties including up to 5 years imprisonment are provided for failure (or causing the failure) to file a report, for filing (or causing the filing) of a false or fraudulent report, and for structuring a transaction.

Recipients of reportable cash payments must also provide each payer with an annual written statement by January 31 of the following year containing the name and address of the recipient, the aggregate amount of reportable cash received from that payer during the year, and a notice that the information in the statement is being furnished to the IRS. The statement must be mailed to the payer's last known address.

File Form 8300 by the 15th day after the date of the transaction with the Internal Revenue Service, Detroit Computing Center, P.O. Box 32621, Detroit, Michigan 48232, or with your local IRS office. California also requires that a copy of Form 8300 be sent to: Franchise Tax Board, P.O. Box 1468, Sacramento, California 95812-1468.

XI. WHEN HIRING NEW EMPLOYEES

A. Compliance with Immigration and Nationality Act

Every time any person is hired to perform labor or services in return for wages or other remuneration, Form I-9 must be completed. Employees can be requested to present to you an original document or documents that establish identity and employment eligibility within 3 business days of the date employment begins. As to the form and timing of the request, we strongly suggest you seek the help of your legal advisor, since incorrect steps could result in being found liable for discrimination practices.

There is no associated filing fee for completing Form I-9. This form is not filed USCIS or any government agency. Form I-9 must be retained by the employer and made available for inspection by U.S. Government officials. Use the new version revised 08/07/09.

Employers hiring foreign nationals should always check for the individual's I-94 card, which controls the terms of an individual's stay in the country. The I-94 serves as the "work permit". Once it expires, the period of lawful stay in the U.S. is over. (The visa, which establishes a specific length of stay, is permission to present oneself at the border).

Nonimmigrant visa categories are arranged according to proposed activities in the U.S. Some typical work visas are E (persons with essential skills), H1-B (temporary professional worker), L-1 (permits international companies to transfer key employees), O (for outstanding individuals), and TN or NAFTA (for Mexicans or Canadians entering to work in the U.S. for one year as architects, scientists or other professionals).

B. Income Tax Withholding

After the first of the year, ask each new employee to complete the year 2009 Form W-4, the "Employee's Withholding Allowance Certificate" which should be available before the first of the New Year. The amount of income tax that an employer must withhold from wages is based on the filing status and number of withholding allowances claimed by the employee. The employee must provide this information on Form W-4.

The requirement to submit copies of the W-4 to the IRS has been eliminated (see Item IV, Section I.) Also, on November 14, 2005, the IRS announced a new procedure for determining the amount of income tax employers are required to withhold from wages paid for services performed by nonresident alien (NRA) employees within the United States, along with new instructions for use by NRA employees in completing Form W-4.



XI. WHEN HIRING NEW EMPLOYEES *(Continued)*

C. New Employee Registry

As part of federal welfare reform, a new law took effect in California on July 1, 1998 requiring all employers to report all new employees to EDD within 20 calendar days of an employee's first day of work. This information will be cross-matched against child support records to locate parents who are delinquent in their support payments and also will be used to detect unemployment insurance fraud.

The correct reporting form is the DE 34. You may also report the new employee by submitting a copy of the employee's W-4 form, as long as you add the start to work date and your California Employer Account number.

To order forms, call the California New Employee Registry at (916) 322-2835. Or if you have questions concerning reporting requirements, call your local EDD office or the Registry at (916) 657-0529.

XII. CAFETERIA PLANS

A Cafeteria Plan is a separate written plan maintained by an employer for employees that meets the specific requirements of and regulations of Section 125 of the Internal Revenue Code. It provides participants an opportunity to receive certain benefits on a pretax basis. Participants in a cafeteria plan must be permitted to choose among at least one taxable benefit (such as cash) and one qualified benefit. A qualified benefit is a benefit that does not defer compensation and is excludable from an employee's gross income under a specific provision of the Code, without being subject to the principles of constructive receipt. Qualified benefits include:

- Accident and health benefits (but not Archer medical savings accounts or long-term care insurance);
- Adoption assistance;
- Dependent care assistance;
- Group-term life insurance coverage;
- Health savings accounts, including distributions to pay long-term care services.

The written plan must specifically describe all benefits and establish rules for eligibility and elections.

A Section 125 Plan is the only means by which an employer can offer employees a choice between taxable and nontaxable benefits without the choice causing the benefits to become taxable. A plan offering only a choice between taxable benefits is not a Section 125 Plan.

The plan may make benefits available to employees, their spouses and dependents. It may also include coverage of former employees, but cannot exist primarily for them. See the questions below for treatment of benefits made available to individuals who are not spouses or dependents of the employee.

Employer contributions to the Cafeteria Plan are usually made pursuant to salary reduction agreements between the employer and the employee in which the employee agrees to contribute a portion of his or her salary on a pre-tax basis to pay for the qualified benefits. Salary reduction contributions are not actually or constructively received by the participant. Therefore, those contributions are not considered wages for federal income tax purposes. In addition, those sums generally are not subject to FICA and FUTA. See Sections 3121(a)(5)(G) and 3306(b)(5)(G) of the Internal Revenue Code.

A flexible spending arrangement (FSA) is a form of cafeteria plan benefit, funded by salary reduction, that reimburses employees for expenses incurred for certain qualified benefits. An FSA may be offered for dependent care assistance, adoption, and medical care reimbursements. The benefits are subject to an annual maximum and are subject to an annual "use-or-lose" rule. An FSA cannot provide a cumulative benefit to the employees beyond the plan year.

The above discussion from the irs.gov website provides only the most basic rules governing a cafeteria plan. For a complete understanding of the rules, see Regulations under Code Section 125.



XIII. RECORDS RETENTION

WARNING: Your circumstances may require that you retain records for a longer period of time than shown below. This is a general schedule. Statute of limitations vary from State to State. Companies should have record retention policies for computer files, word processing and e-mail in addition to the healthy and traditional ledger and paper documents. Prior to formalizing a policy, we recommend consulting your attorneys and accountants for further information.

| <u>Retention Period</u> | <u>Retention Period</u> |
|---|---|
| Accident reports and claims (settled cases) 7 yrs. | Internal audit reports (in some situations, longer retention periods may be desirable) 7 yrs. |
| Accounts payable ledgers and schedules 10 yrs. | Inventories of products, materials and supplies 7 yrs. |
| Accounts receivable ledgers and schedules 10 yrs. | First year Permanently |
| Audit reports of accountants Permanently | Invoices to customers 7 yrs. |
| Bank reconciliations 1 yr. | Invoices from vendors 7 yrs. |
| Canceled checks for important payments, i.e. taxes and purchases of property Permanently | Journals Permanently |
| Canceled checks, bank statements and deposit slips 10 yrs. | Minute books of directors and stockholders, including by-laws and charter Permanently |
| Capital stock and bond records; ledgers, transfer registers, stubs showing issues, record of interest coupons, options, etc. Permanently | Notes receivable ledgers and schedules 7 yrs. (after expiration) |
| Cash receipts and disbursements journals Permanently | Payroll records and summaries, including payments to pensioners 7 yrs. |
| Charts of accounts Permanently | Personnel data 7 yrs. |
| Contracts and leases 10 yrs. (after expiration) | Petty cash vouchers 3 yrs. |
| Correspondence (routine) with customers or vendors 1 yr. | Physical inventory tags 3 yrs. |
| Correspondence (general) 3 yrs. | Plant cost ledgers 7 yrs. |
| Correspondence (legal and important matters only) Permanently | First year Permanently |
| Deeds, mortgages and bills of sale Permanently | Property appraisals by outside appraisers Permanently |
| Depreciation schedules Permanently | Property records - including blueprints, appraisals, and penalties Permanently |
| Duplicate deposit slips 1 yr. | Purchase orders or requisitions (copy) 5 yrs. |
| Employment applications and employee contracts 7 yrs. (after termination) | Receiving sheets 1 yr. |
| Expense reports 7 yrs. | Requisitions 1 yr. |
| Financial statements (end-of-year, other months optional) Permanently | Sales records 7 yrs. |
| General and private ledgers (and end-of-year trial balances) Permanently | Scrap and salvage records (inventories, sales, etc.) 7 yrs. |
| INS I-9 Forms Greater of 3 yrs. From date of hire or 1 year after termination | Stenographer's notebooks 1 yr. |
| Insurance documents (1 - 10 yrs. after expiration or settlement) | Subsidiary ledgers 7 yrs. |
| | Tax returns and worksheets, revenue agents' reports and other documents relating to determination of income tax liability Permanently |
| | Time reports 7 yrs. |
| | Trade mark registrations Permanently |
| | Voucher register, schedules and backup 7 yrs. |
| | Warranties and service agreements 3 yrs. (after expiration) |



XIV. USEFUL IRS PUBLICATIONS AND INTERNET ACCESS

| <i>Pub. #</i> | <i>Name/Description</i> | <i>Pub. #</i> | <i>Name/Description</i> |
|---------------|--|---------------|--|
| 15 | <i>Employer's Tax Guide (Circular E)</i> - Coverage of employer responsibilities to withhold, deposit, report, etc. Supplements, Pub. 15-A and 15-B are also available. | 535 | <i>Business Expenses</i> - Information on business expenses, fringe benefits, and employee benefit programs. |
| 334 | <i>Tax Guide for Small Businesses.</i> | 575 | <i>Pension and Annuity Income</i> - Explains how to report pension and annuity income on federal income tax returns. |
| 463 | <i>Travel, Entertainment, and Gift Expenses</i> - Useful information in determining what is Taxable/nontaxable in the areas of travel, entertainment and gifts. | 926 | <i>Household Employer's Tax Guide</i> - Household employers who pay cash wages of \$1,700 or more per year to an employee are liable for social security taxes on the wages. |
| 505 | <i>Tax Withholding and Estimated Tax</i> - Withholding information for employees. Also includes information on making estimated tax payments on Form 1040-ES. | 966 | <i>Electronic Federal Tax Payment System</i> - Answers common questions as to how to pay your federal business taxes. |
| 508 | <i>Educational Expenses</i> - Includes information on what is job-related versus non-job-related. Helpful for employers in determining taxable/nontaxable reimbursement rules. | 1220 | Contains magnetic media and electronics filing specifications. |
| 509 | Tax Calendars for 2010. | 1679 | <i>A Guide to Backup Withholding</i> - Information for payors required to do backup withholding. |
| 510 | <i>Excise Taxes</i> - It covers the excise taxes reported on Form 720. | 1779 | <i>Independent Contractor or Employee?</i> |
| 521 | <i>Moving Expenses</i> - A primer on the moving expense tax rules following 1993 tax law changes. | 3823 | <i>Employment Tax e-file System Implementation and User Guide.</i> |

NOTE: See new retirement plan guide at www.retirementplans.irs.gov.

Information Available on the Internet

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| Federal: | |
| Center for Disease Control | www.flu.gov |
| Department of Health and Human Services | www.hhs.gov |
| Department of Labor | www.dol.gov |
| Immigration and Naturalization Service | www.bcis.gov |
| Internal Revenue Service (Primary Address) | www.irs.gov |
| Internal Revenue Service (Small Business Help) | www.irs.gov/business/index.html |
| Social Security Administration | www.ssa.gov |
| United States Postal Service | www.usps.com |
| California: | |
| Film Commission | www.film.ca.gov |
| Franchise Tax Board | www.ftb.ca.gov |
| Employment Development Department | www.edd.ca.gov |
| State Controller (Unclaimed Property) | www.sco.ca.gov |
| Board of Equalization | www.boe.ca.gov |
| Secretary of State | www.ss.ca.gov |
| Local: | |
| Los Angeles County Clerk | www.lacounty.info |

Foreign exchange rates at www.federalreserve.gov/releases/h10/hist (1990 to present) or oanda.com.

Consumer information at www.pueblo.gsa.gov.

Stock Market Quotes at www.dailystocks.com or www.moneycentral.msn.com.

General Government Information at www.usa.gov

XV. TYPES OF PAYMENTS

Below is an alphabetic list of some payments and the forms to file and report them. However, it is not a complete list of all payments, and the absence of a payment from the list does not indicate that the payment is not reportable. For instructions on a specific type of payment, see the separate instructions in the form(s) listed.

| Type of Payment | Report on Form | Type of Payment | Report on Form |
|--|-------------------------|---|---------------------|
| Abandonment | 1099-A | Income tax refunds, state and local | 1099-G |
| Accelerated death benefits | 1099-LTC | Indian gaming profits paid to tribal members | 1099-MISC |
| Acquisition of control | 1099-CAP | Interest income | 1099-INT |
| Advance earned income credit | W-2 | Tax-exempt | 1099-INT |
| Advance health insurance payments | 1099-H | Interest, mortgage | 1098 |
| Agriculture payments | 1099-G | IRA contributions | 5498 |
| Allocated tips | W-2 | IRA distributions | 1099-R |
| Alternate TAA payments | 1099-G | Life insurance contract distributions | 1099-R, 1099-LTC |
| Annuities | 1099-R | Liquidation, distributions in | 1099-DIV |
| Archer MSAs: | | Loans, distribution from pension plan | 1099-R |
| Contributions | 5498-SA | Long-term care benefits | 1099-LTC |
| Distributions | 1099-SA | Medicare Advantage MSAs: | |
| Attorney, fees and gross proceeds | 1099-MISC | Contributions | 5498-SA |
| Auto reimbursements, employee | W-2 | Distributions | 1099-SA |
| Auto reimbursements, nonemployee | 1099-MISC | Medical services | 1099-MISC |
| Awards, employee | W-2 | Mileage, employee | W-2 |
| Awards, nonemployee | 1099-MISC | Mileage, nonemployee | 1099-MISC |
| Barter exchange income | 1099-B | Military retirement | 1099-R |
| Bonuses, employee | W-2 | Mortgage insurance premiums | 1098 |
| Bonuses, nonemployee | 1099-MISC | Mortgage interest | 1098 |
| Broker transactions | 1099-B | Moving expense | W-2 |
| Cancellation of debt | 1099-C | Nonemployee compensation | 1099-MISC |
| Capital gain distributions | 1099-DIV | Nonqualified deferred compensation: | |
| Car expense, employee | W-2 | Beneficiary | 1099-R |
| Car expense, nonemployee | 1099-MISC | Employee | W-2 |
| Changes in capital structure | 1099-CAP | Nonemployee | 1099-MISC |
| Charitable gift annuities | 1099-R | Original issue discount (OID) | 1099-OID |
| Commissions, employee | W-2 | Patronage dividends | 1099-PATR |
| Commissions, nonemployee | 1099-MISC | Pensions | 1099-R |
| Commodities transactions | 1099-B | Points | 1098 |
| Compensation, employee | W-2 | Prizes, employee | W-2 |
| Compensation, nonemployee | 1099-MISC | Prizes, nonemployee | 1099-MISC |
| Contributions of motor vehicles, boats, and airplanes | 1098-C | Profit-sharing plan | 1099-R |
| Cost of current life insurance protection | 1099-R | Punitive damages | 1099-MISC |
| Coverdell ESA contributions | 5498-ESA | Qualified plan distributions | 1099-R |
| Coverdell ESA distributions | 1099-Q | Qualified tuition program payments | 1099-Q |
| Crop insurance proceeds | 1099-MISC | Real estate transactions | 1099-S |
| Damages | 1099-MISC | Recharacterized IRA contributions | 1099-R, 5498 |
| Death benefits | 1099-R | Refund, state and local tax | 1099-G |
| Accelerated | 1099-LTC | Rents | 1099-MISC |
| Debt cancellation | 1099-C | Retirement | 1099-R |
| Dependent care payments | W-2 | Roth conversion IRA contributions | 5498 |
| Direct rollovers | 1099-Q, 1099-R, 5498 | Roth conversion IRA distributions | 1099-R |
| Direct sales of consumer products for resale | 1099-MISC | Roth IRA contributions | 5498 |
| Directors' fees | 1099-MISC | Roth IRA distributions | 1099-R |
| Discharge of indebtedness | 1099-C | Royalties | 1099-MISC |
| Dividends | 1099-DIV | Timber, pay-as-cut contract | 1099-S |
| Donation of motor vehicle | 1098-C | Sales: | |
| Education loan interest | 1098-E | Real estate | 1099-S |
| Employee business expense reimbursement | W-2 | Securities | 1099-B |
| Employee compensation | W-2 | Section 1035 exchange | 1099-R |
| Excess deferrals, excess contributions, distributions of | 1099-R | SEP contributions | W-2, 5498 |
| Exercise of incentive stock option under section 422(b) | 3921 | SEP distributions | 1099-R |
| Fees, employee | W-2 | Severance pay | W-2 |
| Fees, nonemployee | 1099-MISC | Sick pay | W-2 |
| Fishing boat crew members proceeds | 1099-MISC | SIMPLE contributions | W-2, 5498 |
| Fish purchases for cash | 1099-MISC | SIMPLE distributions | 1099-R |
| Foreclosures | 1099-A | Student loan interest | 1098-E |
| Foreign persons' income | 1042-S | Substitute payments in lieu of dividends or tax-exempt interest | 1099-MISC |
| 401(k) contributions | W-2 | Supplemental unemployment | W-2 |
| 404(k) dividend | 1099-DIV | Tax refunds, state and local | 1099-G |
| Gambling winnings | W-2G | Tips | W-2 |
| Golden parachute, employee | W-2 | Transfer of stock acquired through an employee stock purchase plan under section 423(c) | 3922 |
| Golden parachute, nonemployee | 1099-MISC | Tuition | 1098-T |
| Grants, taxable | 1099-G | Unemployment benefits | 1099-G |
| Health care services | 1099-MISC | Vacation allowance, employee | W-2 |
| Health insurance advance payments | 1099-H | Vacation allowance, nonemployee | 1099-MISC |
| Health savings accounts: | | Wages | W-2 |
| Contributions | 5498-SA | | |
| Distributions | 1099-SA | | |
| Income attributable to domestic production activities, deduction for | 1099-PATR | | |

