

Radakovich, Shaw & Blythe, LLP

CERTIFIED PUBLIC ACCOUNTANTS

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December 30, 2009

Dear Clients and Friends,

Greetings from Radakovich, Shaw & Blythe, LLP! Please take a few minutes to read the following sales tax and payroll information. If you have any questions regarding the following, please do not hesitate to contact us.

California's New Jobs Credit

A new tax credit of \$3,000 for each additional full-time employee hired is available to small businesses. For purposes of the credit, a small business is one that has 20 or fewer employees on the last day of the previous taxable year. The credit must be claimed on a timely filed original return received by the FTB on or before a cut-off date specified by the FTB. This credit is not subject to the 50% limitation for business credits and the total credit available to be claimed by all taxpayers is capped at \$400 million. The FTB will track the amount of credit generated as returns are filed to determine when to establish the cut-off date and will provide periodic notice on its web site of the cumulative amount of the credit. Under the law, the FTB will grant the credit through the end of the quarter in which the funds are expected to run out. For more information regarding the California's New Jobs Credit, please visit www.ftb.ca.gov.

Changes in Withholding Tables

In 2009 both the Internal Revenue Service and the state of California changed the tables used to withhold income tax from a paycheck. These changes could mean employees owe additional tax with their returns which could include interest and penalties.

In July 2009, the state of California legislature increased required withholding amounts for certain payments made on or after November 1, 2009. Withholding on wages increased 10%, which according to the Governor's press release dated July 28, 2009, is "optional". This means that employees can adjust their withholding to have the proper amount withheld rather than loan money to the state by overpaying. It's not illegal to change withholding to reduce a refund and employees may change it at any time.

Earned Income Tax Credit Notification Requirement to Employees

Effective January 1, 2008, per Assembly Bill 650 California employers must now notify all employees irrespective of income that they may be eligible for the Earned Income Tax Credit. Notice must be given within one week before or after, or at the same time that the employer provides a Form W-2 or similar wage statement to the employee. Employers must notify employees by either handing directly to the employee or mailing to the employee's last known address instructions on how to obtain any notices available from the IRS regarding the Earned Income Tax Credit, including, but not limited to, IRS Notice 797 and Form W-5, or any successor notice or form. Please visit the EDD website www.edd.ca.gov for sample language for the notice.

Sales Tax Information

As of January 1, 2010, the minimum combined state, county, and city sales and use tax rate remains at 8.25% for San Luis Obispo County. The cities of San Luis Obispo, Grover Beach, Pismo Beach, Shell Beach, Arroyo Grande and Morro Bay increased to the higher rate of 8.75% effective July 1, 2009.

The Board of Equalization is converting from paper to electronic filing. In a phased approach, the BOE stopped mailing paper returns to sales and use taxpayers. By the end of 2009, all taxpayers will be eligible for e-filing. The BOE notifies each phase of taxpayers in advance, providing periodic reminders (first by paper, then by e-mail).

The initial notification is mailed separately with subsequent notifications included in the paper returns and prepayment forms mailed to taxpayers. The notifications advise taxpayers that paper returns will no longer be provided, and will include instructions on how to register as an e-client, how to request a one year exemption from e-filing and how to e-file.

Please check the Board of Equalization web site: www.boe.ca.gov for any further information regarding the changes in 2009.

Minimum Wage

The California minimum wage remains at \$8.00 per hour and was last increased January 1, 2008. On July 24, 2009, the Federal minimum wage was increased to \$7.25 per hour. As of January 1, 2010, the Federal minimum wage is scheduled to remain at \$7.25 per hour.

Overtime Wages

With certain key exceptions, employers must pay non-union employees (who are not working an alternative workweek schedule) at least time and one-half pay for:

- Hours worked in excess of eight hours in one day;
- Hours worked in excess of 40 hours in one workweek; and
- The first eight hours worked on the seventh day of work in a given workweek.

In addition, employers must pay employees at least double time for any hours worked in excess of 12 hours in one day and hours worked in excess of eight hours on any seventh day of a workweek.

Exceptions exist for employees who work an alternative workweek schedule. Affected employees may elect by two-thirds vote to work an alternative workweek schedule of up to 10-hour workdays within a 40-hour workweek without being subject to the overtime rules. Also, agricultural employees continue to be exempt from the overtime rules.

Paid Family Leave (SB 1661) and (SB 727)

SB 1661 allows eligible employees to receive up to six weeks of paid leave for the sickness or injury of a family member or domestic partner, or the birth, adoption or foster-care placement of a new child. Employees must incur one week of unpaid leave prior to taking their leave under this law. The State Disability Insurance (SDI) withholding rate includes the tax for the Paid Family Leave program.

SB 1661 **does not** require employers to hold open a position for employees on this leave unless required to do so under some other law, such as the Federal Family and Medical Leave Act (FMLA) or the California Family Rights Act (CFRA). Also, SB 1661 will not extend the 12 weeks of unpaid leave available to employees under FMLA or CFRA.

Employers must supply a notice provided by the California director of employment development about these new insurance benefits to each employee hired on or after January 1, 2004, and to employees leaving work on or after July 1, 2004, because of pregnancy, sickness or dependent care.

The IRS has ruled that benefits received under Paid Family Leave program **are taxable for federal income tax** purposes. The benefits are *not subject to California* income tax. A 1099 will be issued to those who took Paid Family Leave.

Sick Leave for Family Members

Employers must allow workers to use up to half their sick days to care for ill children, parents or spouses. Employers are prohibited from firing, demoting or suspending employees who use sick days to attend to ill family members. However, employers are not required to offer sick leave or to offer more leave than they now do.

Form W-2, Wage and Tax Statement

Furnish Form W-2 to employees after December 31, but no later than January 31, 2010. This is to enable individuals to file their income tax returns early. The W-2 should report total wages paid in the calendar year. The definition of wages includes salaries, vacation allowances, bonuses, commissions, as well as fringe benefits. Other categories that should be included as compensation include but are not limited to:

- Group-term life insurance in excess of \$50,000
- Dependent care assistance
- Personal use of a company vehicle, and
- Health and accident insurance premiums paid by an S Corporation on behalf of 2% or more of shareholders/employees.

Advances paid by you to your employee(s) are included in the definition of wages, and therefore are taxable as wages. Advances are considered taxable when the advance is actually or constructively paid (rather than when you charge the advance against later earnings for services in employment).

You will need to furnish to the Social Security Administration, before February 28, 2010, Form W-3 along with the federal copies of Form W-2. Please note that if you choose to file your 2009 federal forms electronically, the due date is extended to March 31, 2010. Please visit the SSA's Employer Reporting Instructions and Information web site: www.socialsecurity.gov/employer for further information on electronically filing. California employers will only need to file the Annual Reconciliation Return - Form DE-7 by January 31, 2010. Do not file a copy of Form W-2 with the state, as the Franchise Tax Board will receive the wage and withholding information directly from the Employment Development Department.

The Federal Insurance Contribution Act (FICA) tax for employers and employees is imposed at a rate of 7.65%. This rate is a combination of the 6.2% social security tax and the 1.45% Medicare tax.

Wage bases for the two parts of the employment tax are split. The wage base for the social security portion of the tax will remain at \$106,800 in 2010, while the base for the Medicare portion will have no maximum limit. Forms 941 and W-2 for 2010 require employers to report the withholding for social security and Medicare separately.

Fringe Benefits

Fringe benefits are taxable for purposes of income, social security and medicare tax, as well as federal and state unemployment taxes, unless they qualify for exclusion under another IRC provision. Fringe benefits include the personal use of company vehicles, flights on aircraft that you provide, free or discounted commercial flights, vacations, loans, either interest free or below the statutory rate, housing, either rent free or at a reduced rate, debt waiver, vacations, memberships in country clubs or other social clubs, as well as tickets to entertainment or sporting events.

The value of an employee's personal use of a company car is includable in gross income and subject to employment tax, unless it can be specifically excluded as a vehicle that is not likely to be used more than a "de minimus" amount, such as a police vehicle, ambulance, delivery truck, etc., in which case it is a "working condition fringe".

The value is generally its fair market value, but the following optional valuation rules are provided: 1) auto lease valuation rule, 2) vehicle cents-per-mile rule, or 3) commuting-use-only rule. Employees must be notified of your election to use a special rule by no later than January 31 of the calendar year for which the election is to apply. The notice must also alert the employees to the substantiation requirements and the effect of their failure to comply with such requirements.

You may choose whether or not to withhold income tax on the value of your employee's personal use of a company car. If you elect not to withhold, however, you must notify the employee of your election. If you elect to withhold, you may treat the value of the personal use as paid on a pay period, quarterly, semiannually, or on an annual basis.

The employer is required to withhold and pay federal and state employment taxes on the computed personal use of company provided vehicles each calendar year.

Form W-4, Employee's Withholding Allowance Certificate

A new 2010 Form W-4 should be provided to all employees. In addition, you should encourage employees to recheck their income tax withholding situation for 2010. Those employees owing a large amount of tax or receiving a large refund for 2009 may need to file a new 2010 Form W-4 with their employer.

EDD Form DE 542, Independent Contractor Reporting

Any business or government entity that is required to file a Federal Form 1099-MISC, must report specific information to the EDD regarding the independent contractor providing services. You must report independent contractor information to the EDD within 20 days of the earlier of either:

1. Making payments totaling \$600 or more, or
2. Entering into a contract with an independent contractor, which equals or exceeds \$600

EDD Form DE 34, Employee Registry for New Employees

All employers must report the hiring of all new employees within 20 days of hire to the EDD. The requirement applies to all employers, including household employers, nonprofit organization employers and state and local government, regardless of the number of employees. These new hire regulations were passed as part of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, enacted to help enforce child support rulings. Another significant benefit for California employers will be EDD's increased ability to identify persons who are working, but fraudulently collecting Unemployment Insurance benefits. The required information can still be put on the Form DE 34, *Report of New Employees*, or a copy of the employee's W-4 can be sent to the EDD. Please note the EDD has released a new Form DE 34 [Rev 6 (7-08)]. If you use the employee's Form W-4, you must add the employee's start-of-work date, your California employer account number and Federal employer identification number. A penalty may be assessed by the EDD for failure to comply, unless there is good cause.

Federal Payroll Tax Deposit Rules

In 1993, the Internal Revenue Service issued payroll-tax deposit rules that require employers to deposit withheld taxes on either a monthly or semi-weekly basis. All employers must make payroll deposits based on the following rules in order to escape penalties:

- Employers who reported \$50,000 or less in employment taxes during the look back period - July 1 through June 30 of the prior year - will deposit monthly.
- Employers reporting over \$50,000 in employment taxes during the look back are required to make their deposits on a semi-weekly basis.
- Whenever an employer has total accumulated employment taxes equal to \$100,000 or more on any day during a deposit period, they need to make a federal tax deposit the next banking day, whether they are a monthly or semiweekly schedule depositor.

The IRS tax deposit threshold for withheld income and employment (social security and Medicare) taxes is \$2,500. This means that employers with less than \$2,500 of accumulated withheld income and employment (social security and Medicare) taxes in a return period do not have to deposit monthly, but can make their payment quarterly with their Form 941 or annually with their Form 944. This rule also applies to annual returns like Form 943, *Employer's Annual Tax Return for Agricultural*.

Federal Form 944 Small Business Owners

Effective January 1, 2010, employers that would otherwise be required to file Form 944 can notify the IRS if they want to file quarterly Form 941 instead of annual Form 944.

Previous to this, certain employment tax filers were authorized to file Form 944. Form 944 exempts' eligible small employers from filing quarterly returns and subsequently file Form 944, *Employer's Annual Federal Tax Return*. Eligible employers are those with estimated annual employment tax liability of \$1,000 or less.

If you qualify to file Form 944 in lieu of Form 941, *Employer's Quarterly Federal Tax Return*, you should have been notified by the IRS. Do NOT file form 944 unless the IRS has sent you notice telling you to file it. If you believe you are eligible please contact the IRS @ 800-829-4933 to find out if you qualify.

Electronic Federal Tax Payment System

The IRS requires you to make electronic deposits of all depository taxes (such as employment taxes, excise taxes, and corporate income tax) using the Electronic Federal Tax Payment System (EFTPS) in 2010 if the total deposits of such taxes in 2008 were more than \$200,000 or if you were required to use EFTPS in 2009 or any prior year.

The threshold applies to tax deposits during the 2008 calendar-year look back period. Taxpayers whose total aggregate deposits exceeded \$200,000 in 2008 must deposit by EFTPS starting January 1, 2010. Taxpayers that first exceed the threshold in 2008 or a later year must deposit by EFTPS after a one-year grace period. For example, taxpayers that first exceed the \$200,000 threshold during 2008 must deposit by EFTPS beginning in 2010. If you are required to use EFTPS and fail to do so, you may be subject to a 10% penalty.

Once a taxpayer is required to use the electronic system based on the aggregate deposits test, all taxes subject to the tax deposit system must be made electronically. Thus, taxes due with Form 1120, Form 720 (for excise taxes) and even Form 990-T for nonprofits will have to be paid electronically.

State Payroll Tax Deposit Rules

Since 1995, payroll tax payments to the EDD have been made using the state tax deposit coupon – Form DE 88 or through Electronic Funds Transfer (EFT). Taxpayers whose average (per payment) deposits of SDI and PIT totaling \$20,000 or more during their look back period - July 1 through June 30 of the preceding year - are required to remit all SDI and PIT deposits electronically during the next calendar year. First time mandatory EFT filers are notified of their status by October 31 prior to the year of mandatory EFT participation. If you are required to use EFT (electronic funds transfer) and fail to do so, you may be subject to a 10% penalty.

Semiweekly depositors are required to make Semiweekly PIT and SDI deposits if they are required to make federal Semiweekly deposits and accumulate more than \$400 in PIT withholding during one or more payroll periods. Monthly depositors are required to make Monthly PIT and SDI deposits if they are required to make federal Monthly or Quarterly deposits and accumulate \$350 or more in PIT withholding during one or more months of a quarter. If you don't fall in the above categories, your payment of state payroll taxes (PIT, SDI, UI, and ETT) will be due quarterly.

Payroll Tax Rate Changes

The IRS and EDD have changed the payroll tax rates and subject wages for 2010. The attached statement outlines the tentative withholding percentages and wage base limitations. Please keep this sheet with your payroll information for future reference.

Forms 1099, 1098, 5498, 1096, and W-2G, Information Returns

You may need to file information returns to report certain types of payments during the year. For example, you must file Form 1099-Misc to report payments of \$600 or more to persons not treated as employees (i.e. independent contractors) for services performed for your trade or business. You can use the chart in Federal Publication 15, Circular E Employer's Tax Guide, as a quick reference to 2009 information returns.

It is important to have a Form W-9, *Request for Taxpayer Identification Number*, completed by all independent contractors when services are initially performed or when a contract is signed. Please keep a copy for your reference when you issue 1099's.

Standard Mileage Rates

As of January 1, 2010 the standard mileage rates will be:

- 50 cents per mile for business miles driven
- 16.5 cents per mile driven for medical or moving purposes
- 14 cents per mile driven in service of charitable organizations

Internet Resources

If you have Internet access, please refer to the three sites listed below regarding further payroll issues. They are a good source for payroll updates, downloadable payroll forms, and our site contains a wealth of useable general tax information.

- IRS: <http://www.irs.gov>
- EDD: <http://www.edd.ca.gov>
- Radakovich, Shaw & Blythe, LLP: <http://www.radshaw.com>

If we may assist you with any payroll or related issues, please feel free to contact our office.

Have a Happy New Year!

Radakovich, Shaw & Blythe, LLP
Certified Public Accountants

Enclosure

NOTICE TO CLIENTS 2010 PAYROLL GUIDE

The following is an employer's tax guide for 2010 payroll taxes:

	<u>Rate</u>	<u>Limit</u>
<p><u>STATE DISABILITY INSURANCE (SDI)</u> Do not withhold more than \$1,026.48 from any employee in 2010.</p>	.0110	\$93,316
<p><u>STATE INCOME TAX (SIT)</u> Use California withholding schedules for 2010 found in <i>California Personal Income Tax Withholding Guide</i> from the Employment Development Department.</p>		
<p><u>STATE UNEMPLOYMENT INSURANCE (SUI)</u> Your 2010 rate will be mailed to you shortly. Figure the tax by multiplying your rate by that part of the first \$7,000 of each employee's annual wages that you paid during the year.</p>	Your Tax Rate	\$7,000
<p><u>FEDERAL INCOME TAXES (FIT)</u> Use Federal Withholding Schedules for 2010 found in <i>Circular E Employers Tax Guide</i> Publication 15, from the IRS.</p>		
<p><u>FEDERAL INSURANCE CONTRIBUTION ACT (FICA)</u> Withhold 7.65% from the first \$106,800 in wages.</p>	.0765	\$106,800
<p>Withhold 1.45% from wages in excess of the social security limit (\$106,800) with no maximum limit.</p>	.0145	None
<p><u>FEDERAL UNEMPLOYMENT TAX (FUTA)</u> Figure the total tax by multiplying .008 by that part of the first \$7,000 of each employee's annual wages that you paid during the quarter.</p>	.008	\$7,000
<p>All the above figures were confirmed as of this date, however, these figures are subject to change.</p>		
<p>December 30, 2009</p>		

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California: New Registration & Reporting Requirements For Use Tax

Under legislation recently enacted, thousands of California businesses will be required to register with the California State Board of Equalization (BOE), and report and pay any use tax owed for purchases made in the preceding year beginning in 2009. The letter advised you to provide contact information. Whether you provided that information or not, the BOE registered your business because they believe you meet the \$100,000 requirement.

The letter also requests that you file returns and pay use tax that you have not paid for 2007 and 2008. The new use tax registration and reporting law requires "qualified purchasers" to register with the BOE and report and pay use tax. Qualified purchasers are required to file returns by April 15 of each year, reporting all purchases subject to use tax from the previous calendar year, beginning with purchases made during the 2009 calendar year. A "qualified purchaser" is a business that meets all of these tests:

- Is not required to hold a seller's permit with the BOE;
- Is not required to be registered or otherwise register with the BOE;
- Is not a holder of a use tax direct payment permit; and
- Receives at least \$100,000 in gross receipts per year from business operations; both in-state and out-of-state business operations.

The BOE has identified nearly 200,000 businesses that meet the definition of a "qualified purchaser" and is notifying them of their registration requirement. Even if a business is not contacted by the BOE, any business that meets the requirement of a "qualified purchaser" must register with the BOE to report and pay use tax. Under existing law, those businesses who do not meet the \$100,000 gross receipts threshold are still required to report and pay use tax; they just do not have the mandatory obligation to register with the BOE for that purpose.

What is subject to sales and use tax?

What is and is not subject to sales and use tax can be complicated. There are numerous exceptions to the rules, but here are some common ways that people make out-of-state purchases that are subject to use tax:

- Internet purchases;
- Certain foreign purchases;
- Shopping channel purchases;
- Mail-order purchases; and
- Phone-ordered purchases.

These are some common examples of items subject to use tax:

- Machinery and equipment;
- Computers, printers and other electronic equipment;
- Office furniture and supplies;
- Computer programs shipped on a disc; and
- CDs and books.

Items that are exempt from sales tax are also exempt from use tax. Here are a few examples:

- Software that is transferred over the Internet and nothing is mailed to you;
- Newspapers, magazines, and other periodicals; and
- Purchases where the seller added California sales tax to your purchase.

What if another state's sales tax was paid?

If you were required to pay, and did pay, another state's sales tax on the purchase, you may take a credit against the California use tax due. So, for example, if you paid 7% sales tax to another state, you are only required to pay the difference between the 7% and your rate.

When is a return due?

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

Registrants are also being asked to report purchases for 2007 and 2008. The provisions of the new legislation impose a due date of April 15 for use tax reported by qualified purchasers.

However, the provisions of this bill do not change the due date for use tax liabilities from prior years. Therefore, returns for purchases made in 2007 and 2008 were due January 31, 2008 and January 31, 2009, respectively. Penalty and interest applies to payments received after the due date of each return period.

Can a "qualified purchaser" be relieved from penalty and interest charges?

The BOE may grant relief of penalty charges, but not interest, if it is determined that a person's failure to file a timely return or payment was due to reasonable cause and circumstances beyond the person's control.

How can we help you?

We can file the use tax return for you or assist your staff in filing the form. We will need a list of purchases you made where no California sales or use tax was paid but where the item was sent to and first used in California during 2009.

In addition, the BOE may contact you if they believe you have an unpaid use tax liability for a prior year. If this happens, please contact our office immediately so we can limit any potential tax liability and penalties.

BOTTOM LINE:

California has imposed these requirements to get California taxpayers to remit use tax on taxable purchasers where the seller has not charged sales tax. Tax has rarely been remitted to the state voluntarily on these types of purchases due to the difficulty in enforcing compliance.

Therefore, if you meet the conditions to be a "qualified purchaser," then you need to follow the new registration and reporting requirements or you may be subject to penalties and interest. Should you have any questions, please do not hesitate to contact our office.

For more information regarding Use Tax, please visit www.boe.ca.gov