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Emergency Economic Stabilization Act of 2008: Tax Change Highlights

Hoping to bring stability to the financial markets, President Bush signed the emergency economic rescue plan into law on October 3. The new legislation includes a wide range of provisions affecting financial institutions and individuals. For instance, it authorizes the government to spend \$700 billion for troubled financial assets, curbs excessive compensation arrangements for executives of financial firms, raises the FDIC insurance limit to \$250,000 per account until December 31, 2009, and provides relief for certain homeowners.

Although these provisions have been well-publicized, less attention has been paid to the \$100 billion in tax breaks added to the package late in the negotiations. The changes generally extend a series of recently expired tax provisions through 2009. Highlights of the Act's key tax extensions and changes are as follows:

INDIVIDUAL INCENTIVES

Many of the individual incentives are familiar. The new law extends the state and local sales tax deduction (which you can take in lieu of deducting state and local income taxes); higher education tuition deduction, teachers' classroom expense deduction, and tax-free distributions from IRAs for charitable purposes. In all, more than a dozen important tax breaks have been given new life, and are now available for 2008 and 2009.

Alternative Minimum Tax. The rescue package includes good news for individuals who pay alternative minimum tax (AMT). Congress has au-

thorized an AMT "patch" for 2008 to help keep middle-income individuals out of the reach of the AMT by giving them higher exemption amounts and allowing taxpayers to take non-refundable personal credits to reduce their AMT liability. The 2008 exemption amounts are \$69,950 for married couples filing jointly and surviving spouses, \$46,200 for single taxpayers and heads of household and \$34,975 for married couples filing separately for 2008.

New to the AMT patch for 2008 is targeted help for individuals with worthless stock options. At the height of the dot.com boom, many individuals received incentive stock options (ISOs) that were valuable at that time but became worthless after the dot.com bubble burst. The rescue plan abates AMT liability stemming from the exercise of incentive ISOs along with interest and penalties on the unpaid amounts. Additionally, all individuals, including those who paid their ISO AMT liabilities, may accelerate the refund of the minimum tax credit that has not been used.

Homeowner Incentives. Earlier this year, Congress created new tax incentives to help homeowners: the first-time homebuyer's tax credit and the additional standard deduction for real property taxes. Individuals who do not itemize their deductions may be eligible for the additional standard deduction for real property taxes. This deduction was originally available only for 2008. The rescue package extends the deduction through 2009. However, the rescue package does not

extend the first-time homebuyer's tax credit.

When a lender forecloses on property, sells the home for less than the borrower's outstanding mortgage and forgives all or part of the excess mortgage debt, the Tax Code treats the cancelled debt as taxable income to the homeowner. The Mortgage Forgiveness Debt Relief Act, enacted in late 2007, excludes from federal tax those discharges involving up to \$2 million of indebtedness (\$1 million for a married taxpayer filing a separate return) secured by a principal residence and incurred in the acquisition, construction or substantial improvement of the residence. The new law extends this treatment from the end of 2009 through 2012.

Child Tax Credit. Additionally, the rescue package enhances the child tax credit. Before the new law, the child tax credit was refundable to the extent of 15 percent of the taxpayer's earned income in excess of approximately \$12,050 (reflecting inflation adjustments from the original floor of \$10,000). Under the new law, the floor falls to \$8,500. Additionally, the rescue plan changes the definition of a "qualifying child" with respect to age and joint returns, clarifies certain tiebreaker rules and ties the child tax credit to the child dependency exemption.

Energy Conservation. If you install qualifying energy conservation property, such as exterior windows and doors, in your home you may be eligible to a tax break. The new law

extends a number of energy conservation tax incentives and creates a new tax credit for individuals who purchase a plug-in electric vehicle. Solar power, too, has been given a tremendous boost. Both the availability of an unlimited credit for its installation and extensive tax breaks for the solar industry as a whole will drive down energy costs for everyone but especially those with homes that "go solar," at least in part.

BUSINESS TAX INCENTIVES

The business tax incentives in the rescue package are extensive. Highlights are as follows:

Research Tax Credit. The largest business extender is the research tax credit. This credit is available for qualifying research expenses, including wages. The rescue package extends the research tax credit to amounts paid or incurred in 2008 and 2009. It also increases the alternative simplifies research credit to 14 percent starting next year, a tremendous incentive now for smaller firms to finally use the research credit to grow their business.

Remodeling & Improvements. Many businesses remodel or otherwise make improvements to their facilities on a regular schedule. These improvements are usually depreciated over 39 years. The rescue package shortens that period to 15 years for qualifying leasehold, restaurant and retail improvements. However, this special treatment is temporary, so timing these improvements becomes critical.

Charitable Donations. Businesses that donate food to charitable organizations and books and computers to schools may be eligible for a tax deduction. The rescue package extends these tax breaks through 2009.

Alternative Energy. Producers of alternative energy, such as electricity from solar power, biomass and wind facilities also benefit under the rescue package. Congress extended and enhanced various alternative energy tax incentives. Tax breaks for energy ef-

ficient improvements to commercial buildings and energy efficient appliances likewise are extended and in some cases enhanced.

With the price of heating and air conditioning steadily rising, these tax breaks should considerably reduce the pay-back time for these improvements.

Other Business Incentives. The rescue package includes extensions of the New Markets Tax Credit, enhanced depreciation of leasehold, restaurant and retail improvements, brownfield remediation, Indian employment credit, subpart F active financing, look-through treatment of payments between related controlled foreign corporations (CFCs), and enhanced expensing for U.S. film and television production.

The business incentives in the rescue package are not only targeted, however; they are also complex. Please contact us to discuss further.



DISASTER RELIEF

The rescue package helps individuals and businesses recovering from storms and tornadoes that hit the Mid-West earlier this year. Individuals in ten Mid-West states may be eligible for special tax incentives, such as enhanced casualty loss deductions, expensing and depreciation. The rescue plan also includes more limited tax incentives to help victims of Hurricane Ike in Louisiana and Texas along with temporary national disaster relief.

REVENUE RAISERS

To pay for a portion of these tax incentives, Congress included several revenue raisers in the rescue package. For those affected, they also are being referred to as "tax increases."

One of the most wide-reaching is broker basis reporting. The rescue package requires brokers to report the adjusted basis of publicly-traded securities and indicate whether gain is long-term or short-term. Securities subject to the new reporting requirement include stocks, bonds, debentures, commodities, derivatives, and other financial instruments designated by Treasury. The reporting requirement takes effect for stocks acquired in 2011, mutual funds acquired in 2012, and other securities acquired in 2013.

Another revenue raiser targets foreign deferred compensation. It closes a loophole through which Nonqualified deferred compensation plans maintained by foreign corporations will generally become taxable, unless the compensation is deferred 12 months or less after the end of the year that the compensation vests. Deferred compensation would be taxable when the amount is determinable. If the compensation is not determinable when it was deferred, the individual must pay a 20 percent surtax, plus interest, when the amount is determinable. The provision does not apply to an entity whose income is taxable in the U.S. or subject to a "comprehensive foreign income tax."

The rescue package also caps the Code Sec. 199 domestic production activities deduction for oil and gas companies. Additionally, it tightens the rules for oil and gas companies to pay taxes on overseas income. Two special taxes, the oil spill tax and the FUTA surtax, are extended under the new law.

TIME FOR TAX PLANNING

The Emergency Economic Stabilization Act of 2008 is one of the largest tax laws in recent years. You may be able to take advantage of one or more the tax incentives. Please call or e-mail us to discuss these opportunities in more detail prior to year-end.

