CCH Tax Briefing:

EMERGENCY ECONOMIC STABILIZATION ACT OF 2008

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Special Report

HIGHLIGHTS:

- ✔ *Financial Markets Rescue Plan*
- ✔ *$150 Billion In Tax Relief*
- ✔ *Over 290 Changes to the Tax Code*
- ✔ *2008 AMT Patch*
- ✔ *Tax Extenders*
- ✔ *Disaster Relief*
- ✔ *Energy Incentives*
- ✔ *Revised Preparer Penalty Standard*
- ✔ *Enhanced Child Tax Credit*
- ✔ *Broker Basis Reporting*

Inside

President Signs Financial Markets Rescue Plan, AMT Patch, Extenders, Disaster Relief And More

After a tumultuous week, Congress passed and President Bush signed a historic financial markets rescue bill that includes over 100 tax provisions and over $150 billion in separate tax breaks. The *Emergency Economic Stabilization Act of 2008* cleared the Senate on October 1 by a 74-25 vote, followed by a nail-biting 263-171 vote in the House on October 3. The president signed the bill into law at the White House on the same day.

In addition to the major tax provisions that directly address current financial bailout measures, the new law includes a much-anticipated alternative minimum tax (AMT) patch, an extensive package of tax extenders, energy incentives, disaster relief, and more. The *Emergency Economic Stabilization Act's* $150 billion in tax incentives impacts both individuals and businesses. Approximately $44 billion in offsets, however, mean tax increases for certain groups.

Comment. *A version that contained only rescue plan provisions failed in the House on September 29. The Senate then took the lead, gambling on linking the AMT patch, extenders, and disaster relief to the rescue plan, and won.*

Planning Tip. *Although the new law's primary purpose is to solve the credit crunch in the financial markets, it also serves as one of the largest tax bills in recent years. The new law makes almost 300 changes to the Internal Revenue Code. While roughly $150 billion in tax breaks had to be computed over a requisite 10-year period for budget scoring purposes, the lion's share of that outlay provides taxpayer relief immediately in 2008 and 2009. Consequently, year-end tax planning takes on a special urgency this year to maximize taxpayer use of these new tax breaks both before 2008 ends and immediately at the start of 2009.*

FINANCIAL MARKETS RESCUE PLAN

Marathon negotiations between House and Senate lawmakers ended in the financial markets rescue plan (the Troubled Assets Relief Program (TARP)) as one of the main components in the new law. The rescue package includes three major tax-related provisions.

Comment. *TARP has two tracks: the direct purchase program and the auction program. The new law authorizes the government to make direct purchases of troubled assets. Alternatively, the government may acquire them through auction purchases.*

Executive Compensation

Lawmakers took a two-prong approach to curbing excessive executive compensation within those companies directly assisted by the government. In a direct purchase situation, compensation standards will be set by the Treasury Department. The rescue package also limits the deductibility of compensation under Code Sec. 162(m) to $500,000 for CEOs, CFOs, and other executives of qualifying companies participating in TARP auctions, if the company has sold $300 million or more in assets.

> ***Comment.*** *Lawmakers also voted to rein in so-called golden parachutes paid to departing executives. Companies participating in TARP auctions must agree to limit golden parachutes payments; any amounts above that amount will be subject to an excise tax. In a direct-purchase situation, golden parachutes are prohibited.*

> ***Impact.*** *Congress also gave the Treasury Department "claw-back" power in a direct-purchase situation. The government may recover a bonus or other incentive paid to a senior executive of a company participating in the rescue package that had been paid based on statements of earnings, gains or other criteria that later are shown to be materially inaccurate.*

Fannie and Freddie Stock Losses

Under the rescue plan, community banks and other qualifying financial institutions that hold preferred stock in Fannie Mae and Freddie Mac may treat their Fannie Mae and Freddie Mac losses as ordinary losses. This treatment applies to preferred stock that was held on September 6, 2008 or sold or exchanged on or after January 1, 2008, and before September 7, 2008.

> ***Caution.*** *This treatment is only available to community banks and other eligible financial institutions. It is not available to individuals. Additionally, Congress authorized the Treasury Secretary to expand the application of this provision for certain property not held on September 6, 2008.*

"The *Emergency Economic Stabilization Act's* $150 billion in tax incentives impacts both individuals and businesses. Approximately $44 billion in offsets within the new law, however, will mean tax increases for certain groups."

Extended Exclusion for Homeowners

The rescue plan extends a temporary rule for cancellation of indebtedness income. 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.

> ***Comment.*** *The Mortgage Forgiveness Debt Relief Act also helps homeowners whose mortgage debt may have been reduced through a restructuring (also known as a mortgage workout). Short sales and deeds-in-lieu-of-foreclosure are also covered by the extension.*

AMT PATCH

Congress included an alternative minimum tax (AMT) patch in the new law. Under the new law's patch for the 2008 tax year, the AMT 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.

> ***Impact.*** *The patch is designed to insulate middle-income taxpayers from the reach of the AMT. The AMT patch will cost $61.8 billion when measured against what would have been collected without it.*

> ***Reminder.*** *The patch is only for 2008. Hopes are high that in 2009 Congress finally will face up to the need to find a permanent solution to the AMT and pass AMT reform rather than yet another patch.*

Nonrefundable Personal Credits

The patch allows taxpayers to take nonrefundable personal credits to reduce their AMT liability. The law also removes limits in the AMT on taking personal credits against regular tax liability.

> ***Comment.*** *Personal credits include the dependent care credit and education tax credits. The adoption, child and saver's credit were already allowed in full against the AMT and regular tax.*

Incentive Stock Options

The new law provides relief to those high-tech workers and others who were left holding worthless stock options but a large tax bill based on AMT calculations when the tech industry collapsed. The new law will abate AMT liability stemming from the exercise of incentive stock options (ISOs) before 2008, effective for any unpaid tax liability on the law's date of enactment. Interest and penalties on the unpaid amounts would also be abated.

> ***Comment.*** *In September 2008, the IRS announced that it was temporarily suspending collection of ISO AMT in anticipation of Congress taking action.*

The law allows all individuals, including those who paid their ISO AMT liabilities, to accelerate the refund of the minimum tax credit that has not been used. The law also increases the minimum tax credit by 50 percent of any interest and penalties paid before the date of enactment.

INDIVIDUAL INCENTIVES

Tax relief for individual taxpayers in the new law primarily comes in the form of a handful of popular "extenders." These encompass tax breaks that, for many taxpayers, have been considered as permanent provisions because of the expectation of automatic renewal every year or two.

State and Local Sales Tax Deduction

The *American Jobs Creation Act of 2004* and subsequent legislation allowed individuals to deduct state and local general sales taxes in lieu of state and local income taxes. This deduction expired at the end of 2007. The new law makes the deduction retroactive for 2008 and extends it for two years through December 31, 2009.

> ***Reminder.*** *Taxpayers can calculate their deduction either by saving receipts or using the Optional State Sales Tax Tables provided by the IRS.*

Higher Education Tuition Deduction

The new law extends through December 31, 2009, the above-the-line higher education tuition deduction. The deduction allows eligible taxpayers to deduct the costs of qualified higher education expenses paid during the year for themselves, a spouse, or a dependent.

> ***Comment.*** *The deduction continues to be barred to taxpayers whose filing status is married filing separately, or if another person can claim an exemption for the taxpayer as a dependent on his or her tax return.*

> ***Impact.*** *The maximum deductible amount is $4,000 for taxpayers with adjusted gross income not exceeding $65,000 ($130,000 for joint filers). Taxpayers whose income exceeds that limit but does not exceed $80,000 ($160,000 for joint filers) may deduct up to $2,000 in qualified expenses. For many taxpayers, the HOPE or Lifetime Learning credit is also an option.*

Additional Standard Deduction Real Property Taxes

The new law extends the additional standard deduction for real property taxes for non-itemizers through 2009. Congress authorized a maximum $500 additional standard deduction ($1,000 for joint filers) in the *Housing Assistance Tax Act of 2008* but made it available only for the 2008 tax year.

> ***Reminder.*** *The deduction is in addition to the standard deduction. It is not an above-the-line deduction that lowers a taxpayer's adjusted gross income (AGI). For 2008, the $10,900 standard deduction for joint filers will increase to a maximum of $11,900 with the additional standard deduction for non-itemizers, while the $5,450 standard deduction for single individuals will increase to a maximum $5,950, and the head-of-household amount from $8,000 to $8,500.*

Teachers' Classroom Expense Deduction

For 2008 and 2009, teachers and other education professionals can deduct, above-the-line, up to $250 of certain out-of-pocket classroom expenses, including the cost of books, supplies, equipment, and software used in the classroom. First introduced in 2002, this deduction is available to qualified educators regardless of whether or not they itemize their deductions.

> ***Comment.*** *Expenses that exceed $250 and non-classroom supplies may be deducted as an em-*

AMT EXEMPTION AMOUNTS

	2007	2008 with patch	2008 without patch
Married filing jointly and surviving spouses	$66,250	$69,950	$45,000
Single and Heads of Household	$44,350	$46,200	$33,750
Married filing separately	$33,125	$34,975	$22,500

ployment-related miscellaneous itemized deduction subject to the two-percent floor for taxpayers who itemize.

Tax-Free Distributions from IRAs for Charitable Purposes

The new law permits taxpayers to make tax-free distributions from IRAs for charitable purposes through December 31, 2009. This popular charitable contribution option had expired January 1, 2008. The maximum contribution limit for 2008 and again for 2009 is $100,000.

***Impact.** This treatment applies to traditional and Roth IRAs. However, no charitable deduction is allowed for any portion of these withdrawals that would have been otherwise taxable.*

More Individual Incentives

The new law also extends:

- Treatment of certain dividends of Regulated Investment Companies (RICs)
- Estate tax look-through for RIC stock held by nonresidents
- Qualified investment entities treatment

CHILD TAX CREDIT

The new law enhances the child tax credit. The credit is currently 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.

BUSINESS TAX INCENTIVES

The new law includes a host of incentives targeted to businesses, several of which revise as well as extend tax benefits. Among the most significant are revised research tax credit, enhanced depreciation for leasehold and restaurant improvements, and brownfields remediation.

Research Tax Credit

The new law extends the research tax credit to amounts paid or incurred in 2008 and 2009. It also modifies the credit, increasing the alternative simplified credit while repealing the alternative incremental research credit.

***Comment.** Congress first created the alternative simplified credit in 2006. The credit was 12 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding tax years. The new law raises the percentage to 14 percent and makes some technical corrections.*

Leasehold and Restaurant Improvements

Under the new law, qualifying restaurant improvements and leasehold improvements will be eligible for 15-year cost recovery rather than a 39-year period for two more years, through December 31, 2009. Similarly, Congress authorized a 15-year recovery period for depreciation of certain improvements to retail space. This treatment is extended through December 31, 2009.

***Impact.** The treatment applies to both owner-occupied businesses and restaurants, as well as leased establishments.*

Charitable Contributions

The Tax Code gives businesses enhanced deductions for contributions of food to charitable organizations, as well as contributions of books and computer equipment to qualifying schools. The new law extends these tax breaks through December 31, 2009. Additionally, Congress extended the temporary suspension of limitations on charitable contributions in the case of a qualified farmer or rancher contributing food before January 1, 2009.

***Comment.** S corp shareholders are also eligible for special tax treatment when making charitable contributions of qualifying property. The new law extends the special rule allowing S corp shareholders to take into account their pro-rata share of charitable deductions even if such deductions would exceed such shareholder's adjusted basis in the S corp through December 31, 2009.*

New Markets Tax Credit

The new law extends the New Markets Tax Credit through December 31, 2009.

***Impact.** The New Markets Tax Credit is one of the few incentives in the Tax Code to encourage taxpayers to invest in or make loans to small businesses in economically distressed areas. In today's credit crunch, extension of the New Markets Tax Credit may help small businesses secure financing that otherwise would not be available.*

Hurricane Katrina Relief

After Hurricane Katrina devastated the Gulf Coast, Congress passed a package of tax incentives to help individuals and businesses recover. One provision enhanced the Work Opportunity Tax Credit for Hurricane Katrina-affected employers. The new law extends this provision through 2009. Another Katrina-related incentive, the increased rehabilitation credit for structures in the Gulf Opportunity Zone, is also extended through 2009.

More Business Extenders

The new law also extends:

- Seven-year straight-line cost recovery period for motorsports entertainment complexes
- The Code Sec. 199 domestic production activities deduction for qualifying activities in Puerto Rico
- Cover over of rum excise tax to Puerto Rico and the U.S.V.I.
- Qualified Zone Academy Bonds
- Mine rescue training team credit
- Railroad track maintenance credit
- Election to expense mine safety equipment

- District of Columbia first-time homebuyer tax credit
- Indian employment credit; and over 10 more targeted extenders

ENERGY

The new law extends a host of energy tax incentives, some targeted to consumers and others to producers and manufacturers. Many of the extensions go beyond the one or two year periods that Congress authorized for non-energy extenders.

Energy Efficiency and Property

The new law extends several energy-efficiency and energy property tax incentives. The Code Sec. 179D deduction for energy efficient commercial buildings is extended through December 31, 2013. The Code Sec. 25D residential energy efficient property credit is extended through December 31, 2016, along with adding incentives for residential small wind investment and geothermal heat pumps and authorizing taxpayers to use the credit to offset AMT. Congress also reinstated the Code Sec. 25C residential energy property credit for property placed in service in 2009. Additionally, Congress modified the energy efficient appliance credit for manufacturers of qualifying dishwashers, clothes washers, and refrigerators.

> ***Impact.*** *The energy incentive impacting most individuals is the Code Sec. 25C credit for the purchase of residential energy property. A credit of up to $500 is available for nonbusiness energy property that meets the requirements for qualified energy efficiency improvements or qualified residential energy property expenditures. Eligible improvements include insulation materials, exterior windows, including skylights and exterior doors.*

Renewable Energy

Included in the new law are several extended incentives to encourage the production of renewable energy. Congress extended the credit for producing electricity from qualified wind facilities through December 31, 2009, and the credits for producing electricity through biomass and other qualifying renewable sources through September 30, 2011. The credit for solar energy, fuel cell, and microturbine property is extended through December 31, 2016.

> ***Impact.*** *The new law expands the definition of some of the renewable energy sources, such as biomass, enabling more producers to qualify for the tax incentives. To close a loophole, biodiesel fuel that is imported and immediately sold for export is ineligible for the tax incentive retroactive to May 15, 2008.*

Transportation Fringe Benefit

Employees can exclude certain employer-provided transportation fringe benefits from income, such as transit passes and van pooling. The new law extends this treatment to employer-provided transportation fringe benefits paid to employees who commute by bicycle. The exclusion amount is $20 per month. This treatment is effective for tax years beginning after December 31, 2008.

More Energy Incentives

Other energy provisions relate to:

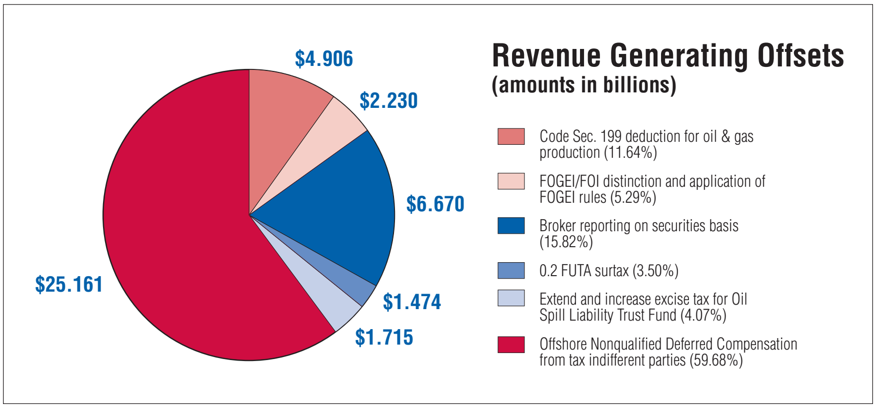
- Coal gasification investment credit
- Clean renewable energy bonds
- Steel industry fuel
- Alternative fuels credit
- Alternative refueling stations credit
- Percentage depletion for marginal wells
- Refinery expensing
- Excise tax on coal to fund Black Lung Disability Trust
- Plug-in electric drive vehicles
- Non-hydrogen alternative fuel refueling property

> ***Comment.*** *Congress also authorized a refund of coal excise taxes that the IRS collected from exporters, which the Supreme Court has deemed unconstitutional.*

DISASTER RELIEF

The new law provides temporary, but significant, tax relief to victims of the severe storms, tornadoes, and flooding that swept through the Midwest in 2008 and – to a lesser extent – victims of Hurricane Ike in Texas. Additionally, Congress authorized national relief for locations declared disaster areas by the president in tax years beginning after December 31, 2007, with some exceptions.

> ***Caution.*** *The Midwestern Disaster Area encompasses presidentially-declared disaster areas in Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and*



Looking Ahead

The new Administration and the new Congress will have lots of tax legislation on the agenda. At the top of the list is the question of whether to extend many of the temporary provisions enacted in the *Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)*, such as the lower individual marginal income tax rates and relief of the marriage penalty. *EGTRRA* also repealed the federal estate tax but just for 2010. These temporary provisions will expire after 2010. Additionally, lower capital gains and dividend tax rates will sunset during the new Administration.

Wisconsin between May 20, 2008, and before August 1, 2008. The Hurricane Ike Disaster Area encompasses parts of Louisiana and Texas, which were declared disaster areas by the president on September 13, 2008.

Midwestern Disaster Area

The tax incentives in the Midwestern Disaster Area mirror many of the ones enacted in 2005 after Hurricanes Katrina, Rita, and Wilma devastated the Gulf Coast. These include increased expensing for demolition, environmental remediation, and clean-up costs, enhanced depreciation for qualified disaster property, education, and housing tax benefits, and a higher standard mileage rate for charitable use of vehicles.

Hurricane Ike Disaster Area

The incentives targeted to the Hurricane Ike Disaster Area are much more limited than the incentives for the Midwestern Disaster Area. Congress authorized temporary tax-exempt bond financing and low-income housing tax relief for certain areas damaged by Hurricane Ike.

Comment. *Victims of Hurricane Ike may be eligible for national disaster relief (discussed below).*

National Disaster Relief

Taxpayers affected by natural disasters (after December 31, 2007, and before January 10, 2010, with some exceptions) may be eligible for increased expensing for qualified disaster expenses, special depreciation for qualified disaster property, enhanced NOL carryback, and other targeted tax breaks.

RETURN PREPARER STANDARD

The *Small Business and Work Opportunity Tax Act of 2007 (2007 Small Business Tax Act)* replaced the "realistic possibility of success standard" in Code Sec. 6694(a) with the heightened "more likely than not standard" for undisclosed, nonabusive positions. The new law removes the more likely than not language under Code Sec. 6694(a) and replaces it with substantial authority. This change is retroactive to the effective date of the *2007 Small Business Tax Act.*

Impact. *The IRS was expected to issue final regulations reflecting the more likely than not standard under Code Sec. 6694(a) before the end of 2008. However, the new law essentially makes these regulations unnecessary.*

Comment. *The new law retains the more likely than not standard for tax shelters and reportable transactions.*

OFFSETS

The new law includes more than $43 billion in revenue raisers, which only partially offset the cost of the extenders and other tax provisions. One of the most expansive offsets is broker basis reporting. Another offset plugs a foreign deferred compensation loophole and still another extends an employment surtax.

Broker Basis Reporting

Reporting by brokers has been expanded. Brokers must report the adjusted basis of publicly-traded securities when reporting sales transactions and indicate whether gain is long-term or short-term. Securities subject to the new reporting requirement include stock, bonds, debentures, commodities, derivatives, and other financial instruments designated by Treasury. Reporting will take effect for stock acquired in 2011, mutual funds acquired in 2012, and other securities acquired in 2013. The provision is estimated to raise $6.7 billion over 10 years.

Comment. *Brokers will use the first-in, first-out (FIFO) method or the average cost method to determine basis, unless the taxpayer provides specific identification of the securities being sold.*

Foreign Deferred Compensation

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. The tax can also apply to partnerships with foreign partners. Deferred compensation will be taxable when the amount is determinable. If the compensation is not determinable when it is deferred, the individual must pay a 20 percent surtax, plus interest, when the amount is determinable. The law applies to compensation for services performed after 2008 and is expected to raise $25 billion.

Comment. *This provision is aimed at compensation schemes for executives who are paid by an entity that is located in a low- or no-tax* *jurisdiction and is "indifferent" to the arrangement because it is not losing a deduction when it defers the income. The provision does not apply to an entity whose income is taxable in the U.S. or subject to a "comprehensive foreign income tax."*

Code Sec. 199 Deduction

Under the new law, the Code Sec. 199 domestic production activities deduction is capped at six percent for oil and gas production. The limit applies to "oil-related qualified production activities income (QPAI)." This includes income from the production, refining, processing, and transportation or distribution of oil or gas, or any primary product of oil and gas. The cap is expected to raise $4.9 billion over 10 years.

Comment. *The deduction for all eligible taxpayers is currently six percent of QPAI. The deduction is scheduled to increase to nine percent in 2010 for all taxpayers except for taxpayers with oil-related QPAI.*

Foreign Tax Credits

The law tightens the rules for oil and gas companies to pay taxes on overseas income. It eliminates the distinction between foreign oil and gas extraction income (FOGEI) and foreign oil-related income from transportation and refining and applies the FOGEI foreign tax credit limitation (Code Sec. 907) to income from oil and gas production and sales. The provision takes effect in 2009 and is expected to raise $2.2 billion over 10 years.

Oil Spill Tax

The oil spill liability trust fund tax has been extended through 2017. The tax will increase from five cents per barrel to eight cents per barrel through 2016 and rises to nine cents in 2017. Congress eliminated the provision that suspends the tax when the trust's unobligated balance reaches $2.7 billion. The change in treatment takes effect in the first quarter that is more than 60 days after enactment of the law and is expected to raise $1.7 billion.

FUTA Surtax

The law extends the 0.2 percent surtax on FUTA (unemployment) taxes for one year, through 2009. FUTA tax is 6.2 percent of wages. The change is expected to raise $1.5 billion. The tax is imposed on the first $7,000 paid to each employee.