

RECENT TAX LEGISLATION and
EMERGENCY ECONOMIC STABILIZATION ACT OF 2008

We are witnessing legislative tax changes at an unprecedented pace. Responding to a fragile economy, Congress has enacted no less than five separate tax bills in just the last twelve months. Collectively, these five Tax Acts have made major changes, including several economic stimulus provisions that are generally available **only in 2008**. These 2008 only changes include: a new individual tax rebate/credit, a dramatic increase in the 179 deduction for the purchase of qualifying business property, a 50% bonus depreciation deduction, an election for corporations to swap the 50% bonus depreciation for refundable AMT and R&D credits, a substantial increase in the first-year depreciation for passenger automobiles used for business, a new additional standard deduction for real property taxes, and a temporary refundable first-time home-buyer credit (up to \$7,500 for purchases **after 4/8/08 and before 7/1/09**). The time to take advantage of these tax breaks is growing short.

This recent tax legislation also includes *long-term* changes, including: expanded income exclusions for qualified home mortgage foreclosures and loan work-outs, liberalized home sale exclusions for surviving spouses, self-employment tax relief for certain retired farmers, an array of tax relief measures for military personnel, a new limitation on the home sale exclusion for a second home that is converted into a principal residence, new AMT relief for low-income housing and rehabilitation credits, and much more!

In light of these significant legislative changes, we are sending this letter to keep you abreast of major tax legislation that we believe will affect the largest number of our clients.

Congress is probably not through for 2008! As we complete this letter, Congress is considering several pieces of **proposed tax legislation** which (if enacted) could include: **1)** temporary AMT relief; **2)** the extension of various popular tax provisions that **expired at the end of 2007** (e.g., \$250 teacher's deduction, state sales tax deduction, qualified tuition deduction, research and development credit); **3)** new tax breaks for purchases of qualified energy-efficient property (and the extension of several existing tax incentives for energy-efficient expenditures); **4)** temporary targeted tax relief for taxpayers in certain federally designated disaster areas; and **5)** changes that will tweak the existing rules for obtaining tax breaks for qualifying children. Some of these provisions may be enacted by the time you receive this letter. If you have heard or read about any recent tax change that is not discussed in this letter, feel free to call our office and we will be glad to give you a status report.

Planning Alert! This letter also contains planning ideas. However, you cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the alternative minimum tax) with and without the strategy. You should also consider any state income tax consequences of a particular planning strategy. We recommend that **you call our firm before implementing any tax planning technique** discussed in this letter, or if you need more information.

INTRODUCTION

Since late December, 2007, President Bush has signed into law the following five tax bills:

- 1) Mortgage Forgiveness Debt Relief Act of 2007 (*2007 Debt Relief Act*)
- 2) Economic Stimulus Act of 2008 (*2008 Stimulus Act*)
- 3) Heartland, Habitat, Harvest, and Horticulture Act of 2008 ("*2008 Farm Act*")
- 4) Heroes Earnings and Relief Tax Act of 2008 (*2008 Heroes Act*)
- 5) Housing Assistance Tax Act of 2008 (*2008 Housing Act*)

Collectively, these tax bills are designed to provide tax relief for homeowners and home buyers in an ailing housing market, generate an economic stimulus to help jump-start the economy, create a package of tax breaks for the farming industry, and provide tax relief to military personnel and their families. This new tax legislation will impact virtually every individual and business taxpayer. As you read the following highlights, please keep in mind that several of the most important economic stimulus tax breaks are available **only in 2008**; other long-term changes are **first effective in 2008**, while some changes are not effective until later. Consequently, pay careful attention to the **effective date** and **sunset date** (if applicable) of each new provision which we **highlight prominently** in each segment.

There is Some Bad News Too! Although most of these tax changes benefit taxpayers, not all of the news is good. In several of these tax bills, Congress imposed new restrictions and limitations on individual and business taxpayers including: a new restriction on the home-sale gain exclusion rule, a potential tax on U.S. citizens who move their citizenship abroad (expatriates) or receive gifts from expatriates, and new limitations for offsetting farm losses against non-farm income. These new restrictions are also highlighted in this letter.

The following summarizes selected provisions of these new tax laws that we think will have the greatest impact on you or your business.

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NEW TAX BREAKS AVAILABLE TO INDIVIDUAL TAXPAYERS

New Temporary First-Time Home Buyer Credit (With Pay-Back Requirement). The *2008 Housing Act* adds a new temporary refundable credit of up to \$7,500 (whether filing jointly or single) for qualified first-time home buyers who buy the house **after April 8, 2008 and before July 1, 2009**. The purchase (i.e., title closing) of your first-time home after April 8, 2008 will qualify even if you signed the purchase contract before April 9, 2008. The amount of the credit is the lesser of: **1)** \$7,500 (\$3,750 if you are married filing separately), or **2)** 10% of the home's purchase price. The credit is phased out as your adjusted gross income (AGI) increases from \$75,000 to \$95,000 if you are single, or from \$150,000 to \$170,000 if you are married filing jointly. Since the credit is refundable, you will actually get a refund to the extent the credit exceeds your tax liability. However, unlike most refundable credits that you can keep, this credit has an automatic 15-year payback requirement that resembles an interest-free loan that must be repaid to the government. The following highlights the requirements for this new credit:

Who Qualifies As A First-Time Home Buyer? To qualify as a "first-time home buyer," neither you nor your spouse can have owned a principal residence in the U.S. during the 3-year period ending on the date of the purchase of your new principal residence. **Tax Tip.** Even if you or your spouse previously owned a home, you can still qualify for the credit, if that ownership ended at least three years before the purchase of your new home. **Planning Alert!** You will **not qualify** for the credit if: **1)** you purchase your home from a related party (e.g., certain family members), **2)** the home is not located in the U.S., **3)** you claimed the D.C. home-buyer credit, or **4)** you bought your home with proceeds from a tax-exempt mortgage revenue bond. **Tax Tip.** Your *principal residence* could include a condominium, houseboat, or mobile home.

How Does The 15-Year Pay Back Work? Subject to certain limitations, you must effectively pay back the credit ratably over 15 years by means of an extra tax on your subsequent tax returns, beginning with the second tax year following the tax year in which the home is purchased. Thus, a qualifying first-time home buyer who buys a principal residence in 2008 and claims a \$7,500 credit, will pay the credit back annually by adding \$500 (\$7,500) for 15 years to his or her tax liability, starting with the 2010 tax return and ending with the 2024 tax return. **Planning Alert!** In general, your credit payback will be accelerated (i.e., recaptured) if you sell the principal residence (or stop using the home as your principal residence) before the end of the 15-year pay-back period. However, upon the sale of the house, any remaining credit in excess of the gain on the sale will not have to be paid back. Also, the homeowner's death will not trigger any recapture. Although transfers as part of a divorce do not trigger the recapture, the spouse who gets the residence will be responsible for the *entire amount* of any remaining recapture tax on the house. **Tax Tip.** In negotiating a divorce settlement, the spouse receiving a residence that originally qualified for the credit should consider any income tax liability for the recapture tax.

What If I Am Not Married To The Co-Owner? Two or more unmarried individuals may purchase a residence and qualify for the credit. However, the total amount of the credit allowed to the individuals jointly may not exceed \$7,500, and the co-owners will be required to allocate the credit in a manner that the IRS will presumably clarify in future guidance.

What If My Home Is Under Construction? A home constructed by the taxpayer generally does qualify if you *move in* after April 8, 2008 and before July 1, 2009, even if the construction began before April 9, 2008.

Do I Have To Worry About AMT? No. The credit is allowed for alternative minimum tax (AMT) purposes.

If I Buy My First Home In 2009, Can I Take The Credit On My 2008 Return? If you purchase your qualifying new residence **after December 31, 2008**, and **before July 1, 2009**, you may elect to treat the purchase as made on December 31, 2008. This election allows you to accelerate the tax benefit of your 2009 purchase by one year. You may even make this election on an amended 2008 income tax return. Presumably, if you make this election, any income phase-out will be based on your 2008 income, even though you purchased the home in 2009. **Tax Tip.** This election is particularly beneficial to college students who graduated in 2008, have income below the income threshold for 2008, and purchase their first home in the first six months of 2009. If the student's 2009 income exceeds the threshold levels, electing to take the credit on the 2008 return will salvage the credit.

New Real Property Tax Deduction for Non-Itemizers (2008 Only). For tax years beginning in 2008 only, if you do not itemize your deductions (i.e., you take the standard deduction), you may claim an *additional* standard deduction for any state and local property taxes you pay. Your deduction, however, is limited to \$500 (\$1,000 in the case of a joint return), or the actual real estate taxes you paid, if less. **Planning Alert!** If you are a homeowner and you itemize your deductions on your 2008 return, this new provision will not benefit you. Also, as with the regular standard deduction, this additional standard deduction is not available in calculating your alternative minimum tax (AMT). **Tax Tip.** Unlike many tax breaks that are limited to your principal residence, this deduction can be claimed for state and local property taxes paid on a second home (if not used for business) as well as your principal residence. Also, this new deduction is available regardless of your income level. Also, as we complete this letter, Congress is considering proposed legislation that would extend this additional standard deduction beyond 2008.

Temporary Home Mortgage Insurance Deduction Extended Through 2010. Last year, Congress passed a provision that allowed qualifying taxpayers to deduct qualified mortgage insurance premiums as home mortgage interest (an itemized deduction) for 2007 only. The *2007 Debt Relief Act* extends this mortgage insurance deduction for three years (**through 2010**). Generally, home mortgage insurance premiums qualify for this deduction only if the policy was **issued after 2006**. Furthermore, whether you file as a single taxpayer or married filing jointly, this deduction begins phasing out once your adjusted gross income (AGI) exceeds \$100,000 (and phases out completely once your AGI exceeds \$109,000). **Planning Alert!** Mortgage insurance premiums with regard to home equity loans will generally not qualify. **Tax Tip.** Premiums on policies issued after 2006 for refinance in 2007 or later of acquisition indebtedness (i.e., mortgages originally taken out to purchase or construct your principal or qualifying secondary residence) should qualify to the extent of the old loan balance before refinancing.

Surviving Spouses Get Home-Sale Exclusion Relief. You can generally exclude up to \$250,000 (\$500,000 for joint returns) of gain realized on the sale or exchange of your principal residence that you have used as your principal residence for at least 2 of the previous 5 years. Under prior law, if a spouse died, the surviving spouse could qualify for the \$500,000 exclusion only if the sale occurred in the tax year of the deceased spouse's death. Under the *2007 Debt Relief Act*, **effective for sales or exchanges after 2007**, a surviving spouse will be able to use

the \$500,000 home sale exclusion (rather than the \$250,000 exclusion) for **sales occurring within 2 years after the death of a spouse**, provided that **1)** the spouses qualified for the \$500,000 exclusion immediately before the death of the deceased spouse, and **2)** the surviving spouse has not remarried by the date of the sale. **Tax Tip.** This new provision should be available to a surviving spouse who sells the home after 2007, even if a spouse died before 2008. Also, this new tax break will be most beneficial to a surviving spouse who was the sole owner of the home before the death of the decedent spouse. In that event, the surviving spouse would have received no step-up in basis on the decedent spouse's death and the expanded opportunity for the survivor to qualify for the \$500,000 exclusion becomes much more important. This is more common with second marriages where the spouse who owned a house before the marriage continues to be the sole owner after the marriage.

Enhanced Deductions For Conservation Easements Extended. Several years ago, Congress enhanced the deduction for charitable contributions of real property for conservation purposes by increasing the deduction limit from 30% to 50% of an individual's modified adjusted gross income. For qualified individual farmers or ranchers, the limit was increased to 100% of modified adjusted gross income, and for qualified corporate farmers and ranchers, the limit was increased from 10% to 100% of modified taxable income. The carryover period of any excess contribution was also increased from 5 years to 15 years. These increased contribution limitations and carryover periods for conservation easements by individuals, farmers, and ranchers were to expire for tax years beginning after 2007. The *2008 Farm Act* extends the increased contribution limitations for two additional years. Therefore, **the increased limits apply to tax years beginning before 2010.** **Tax Tip.** A conservation easement must satisfy several technical requirements to qualify for these increased limits. Therefore, if you or your business is considering the placement of a conservation easement on your real property in favor of a qualified tax-exempt organization, please contact us so that we can evaluate whether you qualify for these tax breaks.

What Do I Need To Know About The Stimulus Rebate Credit? By now, the vast majority of qualifying taxpayers have received their government-issued rebate check. Even though this is technically a credit for the 2008 tax year, your rebate was calculated by the IRS based upon your 2007 income tax return information. The rebates were generally \$600 for individuals, \$1,200 for couples, \$300 or \$600 for certain low-income people, and an additional \$300 for your qualifying dependents under age 17. Even if you otherwise qualify, your rebate credit begins phasing out once your adjusted gross income (AGI) exceeds \$75,000 (\$150,000 for joint returns). For joint filers with no children, the credit will generally be lost entirely when your AGI reaches \$174,000 (single filers with no children will generally lose the entire credit when their AGI reaches \$87,000).

In certain situations, the rules for calculating this rebate can be quite complicated. Fortunately, for the vast majority of taxpayers who qualify, the IRS has already computed the rebate for you and sent you a check. If you have a question about the computation or status of your rebate check, you can access www.irs.gov and click on the link that addresses rebates or stimulus payments. The IRS website also has a frequently-asked questions link which will answer most questions that you might have about this rebate. The following are the questions most frequently asked:

Can I Keep Overpayments? If your rebate check turns out to be greater than your actual 2008 credit, you can keep the excess!

Should I File 2007 Return Even If I Am Below The Filing Requirements? To get the rebate check, you must file a 2007 return (even if you are not required to file). The IRS says

that you can use the simple **Form 1040A** for that purpose. This should be used by taxpayers who are not required to file for 2007 but have at least \$3,000 of any combination of earned income (including nontaxable combat pay), Social Security benefits (excluding supplemental security income), certain Veterans Affairs benefits, and certain Qualifying Railroad Retirement payments.

What If I File Late? Even if you are not required to file, if you file **by October 15**, the IRS plans to give you a stimulus payment before the end of 2008. Otherwise, if you qualify in 2008, you will get the refundable credit when you file your 2008 return.

Do Pension Or Annuity Payments Qualify Me? No. Any pension or annuity amounts do not (by themselves) qualify you.

What If Only One Spouse Has A Social Security Number? If neither you nor your spouse is a member of the military and you are married filing jointly, both spouses must have a valid Social Security number. Otherwise, neither will qualify. However, if you file separately, the spouse with the Social Security number (based on the qualifying spouse's separate income and deductions) could qualify. **Tax Tip.** The IRS says, in this latter situation you can keep the check even if you later amend your 2007 separate return to file "married filing jointly." Military services members have a special rule as discussed later in this letter.

What If I Can Be Claimed As A Dependent? If you qualify as a dependent of another taxpayer, you are not entitled to the rebate even if the other taxpayer does not claim you.

What About Adopted Children? If you adopt a child and have a TIN instead of a social security number for that child in 2007, you will not get the rebate for that child. **Tax Tip.** If you get the Social Security number by the end of 2008, you will get the refundable credit on your 2008 return if you otherwise qualify for the rebate in 2008.

How Do We Treat Joint Checks If We Are Recently Divorced? If the check is made out jointly to spouses who are now divorced, each spouse will be considered receiving one-half.

Is The Rebate Check Taxable Income? No. The stimulus payment is not taxable income.

Should I Keep The Rebate Letter From The IRS? Yes. You should keep your letter reflecting the amount of the rebate, so we can use it to determine how much to reduce your credit for 2008.

New Tax Break for Discharge of Qualified Home Mortgages. Responding to the sub-prime lending crisis, this provision creates a new tax break for certain homeowners who confront home foreclosures, or are engaged in a home mortgage work-out. Generally, any debt you owe that is forgiven or reduced by a lender is taxable to you as debt discharge income, unless you are insolvent or in bankruptcy. The *2007 Debt Relief Act* adds a new exception to debt discharge income. **Effective for discharges of indebtedness after 2006 and before 2010**, if you have a discharge of qualified principal residence indebtedness, you will **not** be required to recognize debt discharge income (even if you are neither insolvent nor in bankruptcy). **Qualified principal residence indebtedness** includes up to \$2,000,000 of home acquisition indebtedness which generally includes only debt where the loan proceeds were used for the **1)** acquisition, **2)** construction, or **3)** improvement of your *principal residence*. **Planning Alert!** This new rule applies only to debt on principal residences and does not apply to second homes, vacation homes, business property, or investment property. It also generally does not apply to discharges of second mortgages or home equity loans. Moreover, the basis in your residence

must be reduced by the debt forgiveness income that you exclude under this new provision. **Tax Tip.** In most cases, this basis reduction rule will not result in additional tax because any gain on the sale or exchange of your home will frequently qualify for the home sale exclusion of \$250,000 (\$500,000 if filing jointly). **Please note** that this new provision is particularly helpful if your principal residence is under foreclosure, or your lender has agreed to reduce your home mortgage balance as part of a loan restructuring. If you find yourself experiencing either of these situations, please call our office and we will help you determine whether you qualify for this new tax break.

Social Security (SECA) Tax No Longer Imposed On CRP Payments Made To Retired Or Disabled Farmers. In 2006, the IRS published an unpopular position that payments made by the USDA under land diversion programs (Conservation Reserve Payments (CRP)) were subject to self-employed social security taxes (SECA tax), even for farmers who are retired or disabled. The *2008 Farm Act* now provides that, **effective for payments made after 2007**, SECA tax will no longer be imposed on CRP payments to individuals who are receiving Social Security retirement or Social Security disability payments.

New Tax Relief for Volunteer Firefighters, Emergency Medical Responders. Many communities rely on volunteer firefighters and emergency first responders. To attract volunteers, communities frequently offer incentives such as property tax abatements to volunteer firefighters, search-and-rescue teams, emergency medical technicians, paramedics, and ambulance drivers. Several years ago, the IRS ruled that reductions or rebates of taxes by state or local governments were taxable income to the volunteers receiving those benefits. **Effective for tax years beginning after 2007 and before 2011**, the *2007 Debt Relief Act* creates an income tax exclusion for any member of a qualified volunteer emergency response organization (e.g., state or local organizations whose members provide volunteer firefighting or emergency medical services) who receives **1)** any qualified state and local benefit, or **2)** any qualified payment. A **qualified state and local benefit** is a reduction or rebate of state or local income or property taxes for services performed by the qualifying volunteer. A **qualified payment** generally is any payment (made as a reimbursement or otherwise) to a qualified volunteer member to the extent the total amount for a tax year **does not exceed \$30 multiplied by the number of months** during the year that the taxpayer performs the services. **Tax Tip.** These new tax-free benefits will also be exempt from Social Security or federal unemployment taxes.

Expanded Opportunity To Secure More Social Security Coverage. Farmers with losses or small amounts of farm profits have long been allowed to voluntarily pay more SECA tax under a farm optional method to earn Social Security benefit coverage. The *2008 Farm Act* changed the law so that, **effective for tax years beginning after 2007**, it will be somewhat easier for farmers (and other non-farmer taxpayers) using either the farm or non-farm optional methods to get a full four quarters of coverage. **Please call** our office if you need more information.

NEW TAX RELIEF FOR MILITARY PERSONNEL

The *Heroes Earnings Assistance and Relief Act of 2008* (2008 Heroes Act) contains tax breaks targeted to service men and women on active duty, reservists who are called to active duty, and military families. Here are *highlights* of the new tax relief under the *2008 Heroes Act*.

Combat Pay Qualifying For EITC No Longer Expires. Tens of thousands of U.S. troops are serving in combat zones around the world and are receiving tax-free combat pay. Prior to 2008, a service member could elect to treat tax exempt combat pay as earned income in determining both eligibility for the earned income tax credit (EITC) and the amount of that credit. This special

election expired after 2007. The *2008 Heroes Act* removes the expiration date for the election so that the election no longer expires.

Military Families Can Get The Stimulus Rebate Without Spouse's Social Security Number.

The IRS has distributed millions of economic stimulus payments over the last several months. When Congress authorized these payments, it required that no stimulus payments could be made to individuals filing joint returns unless each spouse had a valid Social Security number. Under this rule, a service man or woman married to an individual who did not have a Social Security number could not receive a stimulus payment. The *2008 Heroes Act* now provides that a Social Security number is not required for joint returns where **at least one spouse was a member of the U.S. Armed Forces** at any time during the tax year. Therefore, on a joint return where at least one spouse was a U.S. Armed Forces member during the tax year, the rebate credit is allowed even though the return doesn't include both spouses' Social Security numbers. In addition, a qualifying child is taken into account in determining the amount of the credit even though the return doesn't include the child's Social Security number. **Tax Tip.** This provision is particularly helpful to U.S. Armed Forces members who are married to foreign spouses who lack Social Security numbers.

Military Death Benefits May Now Be Contributed To Roth IRAs, Etc. Effective for payments made on account of deaths from injuries occurring after October 6, 2001, the *2008 Heroes Act* generally provides that a recipient of a military death gratuity and/or Service Members' Group Life Insurance proceeds can, within certain time limits, contribute the amounts received to a Roth IRA or Coverdell Education Savings Account (CESA). These contributions will not be subject to the regular CESA or Roth IRA contribution limitations, or the AGI phase-out rules. **Tax Tip.** This gives survivors more choices as to where they can invest these benefits. Generally, the death benefit payments must be contributed to a Roth IRA or a CESA within one year after the receipt of the payment. However, for amounts received because of deaths from injuries occurring **after October 6, 2001, and before June 17, 2008,** the contribution must be made no later than **one year after June 17, 2008.**

State Bonus Payments To Service Members Are Now Tax Free. Many states pay combat veterans a bonus when they return home. Generally, a "qualified military benefit" is nontaxable. **Effective for all open tax years,** the *2008 Heroes Act* clarifies that the term "qualified military benefit" includes any bonus payment by reason of the member's service in a combat zone made by a state or political subdivision to any member or former member of the U.S. uniformed services, or to his dependent. **Tax Tip.** Anyone who paid income tax on these payments can file a claim for a refund for any open tax year (typically three years back) with the Internal Revenue Service.

Sunset Date Removed For Tax-Favored "Qualified Reservist Distributions." The Pension Protection Act of 2006 provided that a "qualified reservist" called to active duty after September 11, 2001 and before December 31, 2007 could take a taxable distribution from an IRA, 401(k) plan, or 403(b) annuity without paying the 10% early distribution penalty. The *2008 Heroes Act* eliminates the **2007 expiration date,** so that this provision no longer expires.

NEW TAX RESTRICTIONS IMPACTING INDIVIDUAL TAXPAYERS

Home-Sale Exclusion Restricted. If you sell your home, you may qualify for the home-sale exclusion which allows you to sell your principal residence and exclude the gain up to \$250,000 (\$500,000 if filing jointly). Generally, to qualify, you must have owned and used the home as your principal residence for at least 2 of the preceding 5 years. Typically, because of the

principal residence requirement, you cannot exclude any gain from the sale of your vacation or second home. This has led some taxpayers to convert a second home into a principal residence for at least 2 years before selling the home, thus qualifying the home for the full \$250,000/\$500,000 exclusion. The *2008 Housing Act* clamps down on this planning technique for **\$250,000 after 2008** by generally requiring you to pay taxes on the portion of the gain that reflects the time the home was not used as your principal residence. **Good News!** This new restriction is not retroactive. Instead, it applies only to sales after 2008. In addition, any periods of personal or rental use before 2009 **are ignored**. Furthermore, if you use a dwelling as your principal residence and then use the residence for non-qualifying purposes (e.g., rental or second home use) during the remainder of the 5-year testing period, the non-qualified use is ignored for purposes of the pro-ration rule. **Tax Tip.** If you currently own a second home or rental home and you convert it to your principal residence on or before **December 31, 2008**, you can generally avoid this new restriction altogether. **Planning Alert!** This new restriction could apply to taxpayers who (after 2008) use a property as a principal residence, rent it out for a period of time, and then later move back in. The actual mechanics for applying this new rule can be complicated. But here are some *highlights* of how it works:

How The Limitation Is Computed. The *2008 Housing Act* requires a pro-rata portion of the gain on the sale of a principal residence otherwise excludable to be recognized where there is a period of non-qualified use of the residence. The amount of gain allocated to periods of non-qualified use is the total amount of gain multiplied by a fraction based on the aggregate periods of *non-qualified use* and *qualified use*.

A Period of Non-Qualified Use. Generally, non-qualified use is any period of use **after 2008** during which the property is not used by you or your spouse as your *principal residence*. However, the following will not be treated as *non-principal residence* use: **1)** any period that occurs in the five years preceding the sale, but after you permanently stop using the home as a main home (in other words, if you first use the dwelling as a principal residence, you then later use the residence as a second home or as rental property and then sell the home, there is no pro-ration of gain under this new rule); **2)** any period of temporary absence (not to exceed an aggregate period of two years) due to change of employment, health conditions, or any other unforeseen circumstances; or **3)** any period (not to exceed an aggregate period of ten years) during which you or your spouse is serving on qualified official extended duty as a member of the uniformed services, the Foreign Service, or the intelligence community.

Example. Let's assume you are single, you bought a beach house on January 1, 2009 for \$400,000, and you used it as a vacation home (which was not your principal residence) for two years. Exactly two years later, on January 1, 2011, you move into the beach house converting it to your principal residence for two years. On January 1, 2013, you move out and again convert the beach house back to your vacation home for one more year, and then you sell the property for \$700,000 on January 1, 2014. Of the \$300,000 gain (i.e., \$700,000 minus \$400,000), 40% of the gain (2 years) or \$120,000, is allocated to non-qualified use which must be taxed to you. Since the remaining gain of \$180,000 is less than the maximum amount of gain (\$250,000) that may be excluded, the remaining gain of \$180,000 is excluded under the home-sale exclusion rules. **Tax Tip.** Note that your one year of *non-principal-residence* use that occurred after you permanently stopped using the beach house as your principal residence is not treated as non-qualified use and, therefore, does not reduce the amount of gain you can exclude under the home-sale exclusion rule.

Renouncing U.S. Citizenship May Now Trigger Taxable Gain. U.S. citizens and long-term U.S. residents are generally subject to tax on their worldwide income. Congress has been

concerned by reports that some taxpayers have avoided U.S. taxes by renouncing their U.S. citizenship or terminating their residency (i.e., expatriating). To address these concerns, **effective for taxpayers who relinquish U.S. citizenship or terminate U.S. residency on or after June 17, 2008**, the *2008 Heroes Act* modifies the regime for taxing expatriates by adding a new mark-to-market deemed sale rule. Under this rule, all property of an expatriate subject to this new rule is treated as sold on the day before the expatriation date for its fair market value. The resulting gain is recognized on the amount of the gain exceeding \$600,000. **Tax Tip.** The Act allows these expatriates to elect to defer the payment of the additional tax until the due date of the return for the tax year in which the property is disposed. Please call our firm if you need more details.

New Transfer Tax on U.S. Citizens Receiving Gifts from Expatriates. The *2008 Heroes Act* created a new transfer tax on any U.S. citizen or resident who receives any covered gift or bequest from a covered expatriate **if received on or after June 17, 2008**. The tax applies to any covered gift or bequest exceeding the annual exclusion amount in effect for gift tax purposes in the year of the transfer (\$12,000 in 2008). The rules are quite technical. Please call our firm if you need additional details.

MISCELLANEOUS TAX CHANGES IMPACTING INDIVIDUAL TAXPAYERS

Highlights Of Miscellaneous Provisions Under The 2008 Heroes Act. The *2008 Heroes Act* included the following changes:

Qualified retirement plans required to provide survivor payments for veterans and may provide additional benefit accruals for veterans who die or become disabled (effective for deaths and disabilities occurring on or after January 1, 2007).

Election to suspend five-year test period for up to 10 years, in determining whether principal residence gain exclusion applies to sales or exchanges by certain Peace Corps employees or volunteers (effective for tax years beginning after 2007).

Rule allowing employees of intelligence community to elect to exclude up to ten years while on qualified official extended duty in determining two-out-of-five year ownership and use test for home gain exclusion will no longer sunset after 2010.

Unused FSA balances may be distributed to qualified reservists called to active duty without disqualifying plan (effective for distributions made after June 17, 2008).

NEW TAX BREAKS AVAILABLE TO BUSINESS TAXPAYERS

Increased 179 Deduction For Tax Years Beginning In 2008. For tax years beginning in 2007, your business could have deducted (under 179) up to \$125,000 of the cost of qualifying depreciable business property (e.g., machinery and equipment). Also, for 2007, this deduction phased out dollar-for-dollar for the cost of your 179 property exceeding \$500,000. **Effective for tax years beginning in 2008**, the *2008 Stimulus Act* increases the maximum 179 deduction to \$250,000. In addition, the \$250,000 deduction is reduced by the amount by which the cost of qualifying 179 property placed-in-service during the 2008 tax year exceeds \$800,000. **Planning Alert!** This increased 179 limit is available only for one year (i.e., **for tax years beginning in 2008**). Thus, if your business is a *calendar-year* taxpayer, the increased 179 deduction is available only if the qualified property is placed-in-service **by December 31, 2008**. For

calendar-year taxpayers to be safe, your qualified property should be set up and tested **before 2009**. **Tax Tip.** If you are considering a significant equipment or business vehicle purchase, please call our office. We will help you develop an equipment/vehicle purchase strategy that gives you maximum depreciation deductions.

Gulf Opportunity Zone (GO Zone) Property. The enhanced 179 deductions and beginning-of-phase-out levels available for qualified property placed-in-service in the *Gulf Opportunity Zone* (GO Zone) are available **in addition to** the increased regular 179 maximum expense deduction and the increased phase-out threshold under the *2008 Stimulus Act* for **tax years beginning in 2008**.

The 50% Bonus Depreciation Is Back (For Calendar Year 2008 Only). The original bonus depreciation was first allowed following the terrorist attacks of 2001 and generally sunset after 2004. The *2008 Stimulus Act* reinstates the 50% bonus depreciation deduction. The 50% bonus depreciation deduction generally applies for **new** qualifying property **acquired and placed-in-service during calendar year 2008**. **Caution!** Property acquired pursuant to a binding contract entered into before 2008 does not qualify. **Tax Tip!** IRS says that an option to acquire property is not a binding contract. **Planning Alert!** Remember, whether your business uses a fiscal or calendar tax year, the 50% bonus depreciation is allowed only if qualified property is acquired and placed-in-service **during calendar year 2008**. To meet the placed-in-service requirement, property must be ready and available for use during 2008. Also, the 179 deduction (discussed above) must be taken before the 50% depreciation.

Illustration. Let's assume that you are a small business owner who paid \$400,000 for a qualifying asset (e.g., equipment) purchased and placed it in service in 2008. Assuming that you want maximum deductions, you must first deduct the new maximum 179 deduction of \$250,000. That leaves a remaining basis of \$150,000 that has not yet been depreciated. Next, you would apply the 50% bonus depreciation deduction to the remaining \$150,000 for an additional deduction of \$75,000. That leaves \$75,000 to which you can apply the regular depreciation rules. Assuming that the asset is 5-year property, you would generally deduct 20% of the remaining \$75,000 cost basis in the first year, for an additional \$15,000 depreciation deduction. So, for 2008, you would be deducting a total of \$340,000 (\$250,000 + \$75,000 + \$15,000), or 85% of the original \$400,000 cost. **Tax Tip.** If you have both new and used 179 property acquisitions for 2008 and your total acquisitions of 179 property are more than \$250,000, you should generally elect 179 for the *used* property first. Any 179 depreciation taken on used property will not reduce the 50% bonus depreciation deduction for the year since the 50% depreciation deduction is not allowed for used assets.

Alternative Minimum Tax (AMT). There is no AMT impact with respect to 50% bonus depreciation property unless the taxpayer elects not to take the 50% bonus depreciation.

Qualifying Property. Generally, the 50% deduction applies only to property that has a depreciable life for tax purposes of 20 years or less. **The following are examples of the types of property that could qualify:**

General. Machinery and equipment; furniture and fixtures; breeding hogs; cars and light general purpose trucks; taxis and buses; airplanes; typewriters, calculators, adding and accounting machines, copiers, duplicating equipment, and similar equipment; computer-based telephone central office switching equipment; computers and peripheral equipment; breeding cattle; dairy cattle; certain livestock 12 years old or less when placed into service; fishing vessels; barges; tugs; and single purpose agriculture or horticultural structures; land improvements (e.g., sidewalks, roads, shrubbery, sewers,

drainage facilities, fences, landscaping, etc.); service station buildings and certain convenience store buildings that sell gasoline; farm buildings; and **depreciable computer software**. **Planning Alert!** Remember, **this is only a partial list** of qualifying property. If you have a question about property that we have not listed, call us and we'll help you determine if it qualifies.

Qualified Leasehold Improvements. Certain leasehold improvements may also qualify for the 50% deduction. To qualify, the leasehold improvement must be made to the interior portion of a commercial building (i.e., non-residential real property) pursuant to a lease (or a binding commitment to enter a lease). The lessor, lessee, or the sub-lessee may make the improvements, provided the leasehold improvement is placed into service more than 3 years after the building was **first** placed into service, and the improved portion of the building is occupied exclusively by the lessee (or any sub-lessee). **Planning Alert!** The following leasehold improvements will **not qualify**: **1)** improvements that enlarge the building; **2)** any elevator or escalator; **3)** any structural component benefiting a common area; and **4)** any cost relating to the internal structural framework of the building. Furthermore, improvements under **a lease between related persons** do not qualify. The definition of a related person is quite technical. Please call our office if you need further information.

Tax Tip. Make sure you properly classify land improvements as 15-year property (and not as part of the building) since land improvements qualify for the 50% bonus depreciation, and buildings generally do not. Furthermore, property within a new building that is not a structural component of the building (e.g., pursuant to a *cost segregation study*) may be treated as tangible personal property. For example, some courts have held that carpeting; wallpaper; decorative fixtures and millwork; movable partitions; and other portions of a building that are not structural components qualify as tangible personal property. If you can effectively segregate these costs, you may qualify for three favorable depreciation benefits: **1)** 179 treatment, **2)** the 50% bonus depreciation deduction, and **3)** regular depreciation write-offs.

Used Property Generally Does Not Qualify. You will qualify for the additional 50% bonus depreciation **only** if your business is the first taxpayer to actually use the qualified property. Therefore, if your business purchases used property, it will generally not qualify for the 50% deduction. Moreover, factory reconditioned or rebuilt machinery or equipment will generally not qualify. However, if your business incurs capital expenditures to recondition, rebuild, or refurbish qualifying property it acquires (or already owns), the capital expenditures will qualify for the new 50% deduction. **Tax Tip.** You will receive larger depreciation deductions if you buy used equipment and recondition it yourself, rather than buying reconditioned equipment. Also, the IRS has said that equipment that contains used parts is not used (and therefore may qualify for the 50% bonus depreciation) if the cost of the used parts do not represent more than 20% of the total cost of the equipment. **Planning Alert!** Special rules apply if your business participates in certain sale-leaseback transactions of otherwise qualifying property.

Converting From Personal to Business Use. The IRS has also said that if you acquire qualifying property for personal use during 2008 and convert it to business use **before January 1, 2009**, you can take the 50% bonus depreciation for the year the property is converted to business use. **Planning Alert!** The depreciable basis of the property is the lower of the property's cost or fair market value on the date it is converted to business use.

Like-Kind Exchanges and Involuntary Conversions. IRS regulations clarify that the entire depreciable basis of qualifying property acquired in a like-kind exchange or as the result of an involuntary conversion qualifies for the 50% bonus depreciation. **Tax Tip.** This rule could apply, for example, where you trade in an existing business vehicle for a new business vehicle.

You May Elect Out Of The 50% Bonus Depreciation. Generally, the 50% bonus depreciation is automatic unless you timely elect out of the deduction. You generally must elect out by the due date of your tax return (including extensions). **Tax Tip.** You may wish to elect out of this 50% deduction if you determine you will get a greater tax benefit by deferring depreciation deductions into later years. **Planning Alert!** Careful calculations (including alternative minimum tax implications) should be made before deciding to elect out of the 50% bonus depreciation.

Corporations May Swap 50% Bonus Depreciation For Refundable AMT and Research and Development Credits. Corporations currently incurring losses may receive minimal tax benefit from the 50% bonus depreciation. The *2008 Housing Act* allows corporations to elect to treat certain unused alternative minimum tax (AMT) and research and development (R&D) credits attributable to tax years **beginning before 2006** as refundable credits in lieu of claiming bonus depreciation for "eligible qualified property" **placed-in-service after March 31, 2008.** **Tax Tip.** If your corporation currently has unused AMT and/or R&D credits, and also has existing net operating losses, this election may be particularly beneficial. **Planning Alert!** These rules are complex and it will require detailed analysis to determine whether your corporation could benefit from this election. We will be glad to assist you with this analysis.

No Double 50% Bonus Depreciation for GO Zone Property. Under the Gulf Opportunity Zone Tax Act of 2005 (*GO Zone Act*), certain property placed-in-service in the portions of the GO Zone most damaged by Hurricane Katrina are classified as "specified Gulf Opportunity Zone Extension Property" and currently qualify for a temporary 50% additional depreciation deduction (even without the *2008 Stimulus Act*). So that taxpayers cannot take a double 50% deduction, property that otherwise qualifies for the 50% bonus depreciation deduction under the *2008 Stimulus Act*, will not in addition qualify for the GO Zone 50% bonus depreciation deduction.

Bonus Depreciation for Passenger Automobiles. The maximum annual depreciation deduction (including the 179 deduction) for most *passenger automobiles* used in a business is capped at certain dollar amounts. For example, for 2008, the maximum first year depreciation on a business automobile is generally capped at \$2,960 (\$3,160 for trucks and vans not weighing over 6,000 lbs). Under the *2008 Stimulus Act*, for passenger autos otherwise qualifying for 50% bonus depreciation, the first year depreciation cap is increased from \$2,960 to \$10,960 (for trucks and vans not weighing over 6,000 lbs, the increase is from \$3,160 to \$11,160).

Trucks And SUVs Over 6,000 Lbs. SUVs with loaded vehicle weights over 6,000 lbs are exempt from the passenger auto annual depreciation caps discussed above. However, these heavy SUVs are required to limit the 179 deduction to \$25,000 (instead of \$250,000 for 2008). For example, for a new over-6,000 lb SUV used entirely for business that is placed-in-service by a calendar-year taxpayer in 2008: **1)** up to \$25,000 of the cost can be deducted immediately under 179, **2)** 50% of the remaining balance can be claimed as bonus depreciation, and **3)** 20% of what's left can generally be taken as regular depreciation for the first year. Thus, for a \$50,000 new heavy SUV placed-in-service this year, \$40,000 could be written off in 2008

(assuming 100% business use). Pickup trucks with loaded vehicle weights over 6,000 lbs are exempt from the \$25,000 limit under 179 (imposed on SUVs) if the truck bed is at least six feet long. **Planning Alert!** If you take the 179 deduction and/or the first year additional depreciation deduction on a SUV or truck weighing over 6,000 lbs, and your business use percentage later drops to 50% or below, you may be required to bring into income a significant portion of the depreciation taken in previous years. Also, it has been widely reported that the \$25,000 deduction for SUVs over 6,000 lbs. may be on the chopping block as Congress searches for ways to increase tax revenues. 2008 may be the last year for this tax break.

Small Firms Get New Credit for Make-Up Wages to Called-Up Reservists. When a reservist is called to active duty, some employers voluntarily pay the difference between the reservist's regular pay and his or her military pay. The *2008 Heroes Act* creates a new tax credit for an eligible small business employer who makes *qualified* differential wage payments **after June 17, 2008 and before 2010** to employees who are on active military duty. The credit is equal to 20% of the eligible differential wage payments for each of the qualified employees of the taxpayer. To qualify for the credit, your business generally must employ an average of fewer than 50 workers a year. The maximum amount of differential wage payments to any one employee qualifying for the credit may not exceed \$20,000 for a tax year. Thus, the maximum credit for a single employee is \$4,000. **Planning Alert!** The *2008 Heroes Act* also creates new rules for the treatment of qualified differential payments for retirement plan and wage withholding purposes. **Tax Tip.** Please contact us if your business is paying employees who are on active military duty and we will help you determine if you qualify for this new credit.

Temporary 15% Rate for Qualified Timber Gains of C Corporations. Effective for timber transactions after 5/22/08 and before 5/23/09, the *2008 Farm Act* provides a 15% tax rate for the portion of a C corporation's taxable income that consists of qualified timber gains for a tax year. Generally, "qualified timber gains" are gains where the timber has been held for more than 15 years. The maximum 15% rate also applies for AMT purposes.

Farmers Allowed Deduction For Expenditures Relating To Endangered Species Recovery Act. Under the *2008 Farm Act*, expenditures **paid or incurred after 2008** by a taxpayer engaged in the business of farming for the purpose of achieving site-specific management actions under the Endangered Species Act of 1973 will be treated the same as the soil and water conservation expenditures and anti-erosion expenditures under 175. Accordingly, the expenditures will be deductible up to 25% of the gross income derived from farming.

Three-Year Depreciable Life for All Race Horses. For race horses placed-in-service before 2009, the race horse is assigned a three-year recovery period if, at the time it is placed-in-service, it is more than two years old (i.e., more than 24 months old). A race horse that is ineligible for a three-year recovery period has a seven-year recovery period. Under the *2008 Farm Act*, all race horses **placed-in-service after 2008 and before 2014** will have a three-year recovery period. **Tax Tip.** This essentially means that horses up to two years old will now get a 3 year write-off, instead of the 7-year depreciation period under previous law.

NEW TAX LIMITATIONS IMPACTING BUSINESS TAXPAYERS

Increased Penalties For Failing To File Partnership Or S Corp Returns. Previously, there was a penalty of \$50 per month/per partner for failing to file a partnership return. The penalty applied for a maximum of 5 months. Therefore, the maximum penalty was \$250 per partner. In addition, there was previously no comparable penalty for failure to file an S corporation return. **For returns required to be filed after December 20, 2007**, the *2007 Debt Relief Act* generally

increases the penalty for failing to file a partnership return or an S corporation return to \$85 per month/per owner for a maximum period of 12 months. Therefore, the maximum penalty **per partner** in a partnership or **per shareholder** in an S corporation is generally \$1,020.

New Farm Loss Limitations for Farmers Receiving Federal Farm Payments or CCC Loans. Effective for tax years beginning after 2009, the *2008 Farm Act* limits the amount of farm losses of taxpayers (other than C corporations) that may offset non-farm income where the taxpayer receives certain farm subsidies. The farm subsidies that cause the new limitation to "kick in" include any direct or counter-cyclical payment under Title I of the Food, Conservation and Energy Act of 2008, or any payment elected to be received in lieu of any direct or counter-cyclical payment under the Food, Conservation and Energy Act of 2008, or any Commodity Credit Corporation (CCC) loan. Once this new limitation applies, the net farm losses for the year that may offset non-farm income are limited to the greater of **1)** \$300,000 (\$150,000 for married individuals filing separately), or **2)** the total net farm income for the past five years. Any loss disallowed because of this new provision is carried over and treated as a loss in the subsequent tax year.

MISCELLANEOUS TAX CHANGES IMPACTING BUSINESS TAXPAYERS

Highlights of Modifications to AMT Rules Under the 2008 Housing Act. The *2008 Housing Act* made a series of targeted changes to the alternative minimum tax (AMT), including:

Certain Housing Bonds Exempt From AMT Add Back. The Act excludes tax-exempt interest on certain housing bonds **issued after July 30, 2008** from being a preference item for AMT purposes.

Low Income Housing Credit May Offset AMT. The low-income housing credit attributable to buildings **placed-in-service after December 31, 2007**, can be used to offset AMT.

Rehabilitation Credit May Offset AMT. The rehabilitation tax credit to the extent attributable to qualified rehabilitation expenditures **properly taken into account for periods after December 31, 2007**, can be used to offset AMT.

REIT Reforms. A package of changes liberalizing the REIT rules.

Highlights of Miscellaneous Provisions Under the 2008 Stimulus Act. The *2008 Stimulus Act* included the following technical changes:

Stock in mutual ditch, reservoir, or irrigation companies can qualify for 1031 exchange treatment (effective for exchanges completed after 5/22/08).

New 30% security credit for businesses selling, manufacturing, distributing or aerially applying agricultural chemicals (generally effective for amounts paid or incurred after 5/22/08 and before 2013).

Liberalized rules for REITS relating to timber income and certain sales of real estate (effective for tax years beginning after 5/22/08).

New credit for qualified cellulosic biofuel production (effective for fuel produced after 2008 and before 2013).

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes and will gladly discuss any current tax developments and planning ideas with you. Please call us before implementing any planning ideas discussed in this letter, or if you need additional information.

Note: The information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

Circular 230 Disclaimer: Any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of **1)** avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions, or **2)** promoting, marketing, or recommending to another party any transaction or matter addressed here.

EMERGENCY ECONOMIC STABILIZATION ACT OF 2008

On October 3, 2008, in an attempt to restore liquidity to the financial markets, President Bush signed the massive Emergency Economic Stabilization Act of 2008 (*2008 Stabilization Act*). To facilitate the bill's passage, Congress attached more than \$150 billion of tax incentives including: alternative minimum tax relief; the extension of a host of expiring business and individual tax breaks; an enhanced \$1,000 child credit; a refined qualifying child definition; more rapid write-offs for qualifying capital improvements to buildings leased or used for restaurant or other retail purposes; special provisions for disaster victims; and expanded tax incentives for certain energy-efficient expenditures.

We are sending this letter to keep you abreast of these critically important Federal tax changes. This new tax legislation will impact virtually every individual and business taxpayer. As you read the following highlights, please keep in mind that several of these tax breaks require quick action before the 2008 tax year ends, while others encourage planning now to maximize the benefits available in 2009 and beyond. Consequently, pay careful attention to the **effective date** and **sunset date** (if applicable) of each new provision which we **highlight prominently** in each segment.

To help you locate items of interest, we have divided highlights of the new tax legislation into the following categories:

- **Expiring Provisions Extended**
 - New Sunset Dates for Provisions Impacting Primarily *Individuals*
 - New Sunset Dates for Provisions Impacting Primarily *Businesses*
- **Other Provisions Impacting Primarily Individual Taxpayers**
- **Other Provisions Impacting Primarily Business Taxpayers**
- **New, Enhanced, and Extended Energy-Related Tax Incentives**
- **Tax Relief for Recent National Disaster Areas**

Planning Alert! We highlight only *selected* provisions of the *2008 Stabilization Act*. If you have heard or read about any provision not discussed in this letter, feel free to call our office. We will

help you determine how the provision impacts you or your business. This letter also contains planning ideas. However, you cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the alternative minimum tax) with and without the strategy. You should also consider any state income tax consequences of a particular planning strategy. We recommend you call our firm before implementing any tax planning technique discussed in this letter, or if you need more information.

HIGHLIGHTS OF EMERGENCY ECONOMIC STABILIZATION ACT OF 2008

EXPIRING PROVISIONS EXTENDED

In recent years, Congress has placed expiration dates (sunset dates) on many popular business and individual tax provisions. For example, all of the tax rate cuts Congress has enacted since 2001 (i.e., top individual, estate, gift, generation-skipping, capital gain, and qualified dividend tax rates) are presently scheduled to sunset after 2010. Prior to the *2008 Stabilization Act*, there was a long list of other popular tax breaks that expired for years after December 31, 2007. The new legislation **extended the expiration date for many of these tax breaks through 2009.**

New Sunset Dates for Provisions Impacting Primarily Individuals. The following *selected* tax breaks impacting primarily individuals now have the following expiration dates:

Selected Expiring Tax Provisions Extended Through The End Of 2009: **1)** School Teachers' Deduction (Up to \$250) for Certain School Supplies; **2)** Deduction for State and Local Sales Tax; **3)** Deduction (up to \$4,000) for Qualified Higher Education Expenses; **4)** New Real Property Tax Standard Deduction For Non Itemizers; **5)** Qualifying Tax-Free Transfers from IRAs to Charities for those at least 70-1/2; and **6)** Increased Charitable Deduction Limits for Qualifying Conservation Easements.

Alternative Minimum Tax (AMT) Relief Extended Through 2008. Without the *2008 Stabilization Act*, a taxpayer would have received an AMT exemption of only \$33,750 (individuals) and \$45,000 (married filing jointly) for 2008, and there would have been no AMT offset for many personal tax credits. If these exemptions had not been increased to reflect 2008 inflation rates, IRS says the number of taxpayers paying AMT in 2008 would have increased from approximately 4 million to 25 million. The *2008 Stabilization Act* increased the AMT exemption amounts, **for 2008 only**, to **\$46,200** (individuals) and **\$69,950** (married filing jointly). The Act also extended, **for 2008 only**, the ability to use certain personal credits (including the dependent care, elderly and disabled, HOPE, Lifetime Learning, and D.C. home buyer credits) against AMT. **Planning Alert!** The items that commonly trigger AMT for individual taxpayers include: high state and local taxes, an unusually large number of dependents, large medical expenses, or the exercise of an incentive stock option. If you anticipate having significant amounts of any of these items, contacting us early will increase our chances of helping you minimize your AMT for 2008.

The Refundable AMT Credit. Many companies offer tax-favored incentive stock options (ISOs) as compensation. Under the *regular tax rules*, ISOs are not taxed upon exercise. Under the *AMT rules*, however, upon exercise, a taxpayer must include the excess of the stock value over the exercise price in income. The economic downturn in 2000 resulted in many individuals having to pay tax on "phantom income" because the stock prices dropped dramatically after the date of exercise. Starting in 2007, Congress provided relief for these and other AMT situations. Subject to certain income phase-out thresholds, the 2007 law created a new *refundable* AMT credit for any "long-term unused AMT credit" (i.e., an AMT credit generated more than 3 years prior to the current year). So, to have a *long-term unused AMT credit* for 2008, it must have been generated **in years prior to 2005.**

Previously, this refundable AMT credit was generally recovered 20% per year (stretching it over a 5-year period). **Effective for tax years beginning after 2007 and before 2013**, the *2008 Stabilization Act*: **1)** generally allows 50% of *long-term unused AMT credits* to be used over each of 2 years (instead of 20% over each of 5 years), **2)** eliminates the income phase-out

altogether, **3)** increases your *long-term unused AMT credit* by any interest and penalty you **paid before October 3, 2008** on AMT attributable to ISO income, and **4)** completely abates any AMT *attributable to the exercise of ISOs* **for any tax year ending before 2008** that remains outstanding **on October 3, 2008**, including interest and penalties. **Planning Alert!** Although the new 2-year refund period and the elimination of the income thresholds apply to all long-term unused AMT credits, the tax abatement provision described above (item 3) applies **only** to those AMT credits that arose from exercising ISOs. **Tax Tip.** This new provision is great news if you exercised ISOs before 2008 and failed to pay the resulting AMT liability (or the applicable interest and/or penalties) by October 3, 2008. You are now completely relieved of this liability. Also, if you have paid AMT in the past (or you previously paid interest and/or penalties on AMT triggered by an ISO), you may qualify for a refundable AMT credit for **2008 and 2009** that could actually generate a cash refund to you. Remember, with this new law change, you can qualify for this AMT relief regardless of your income level.

Existing AMT Rules For Exercising ISOs Continue To Apply. Going forward, the *2008 Stabilization Act* does not eliminate the current AMT impact of exercising ISOs. **Planning Alert!** Exercising an ISO in 2008 could still generate a 2008 AMT if the difference between the stock's value and the exercise price is substantial. **Tax Tip.** If you exercised an ISO **in 2008** and the stock you acquired has declined in value since the date of exercise, it may be possible to eliminate or reduce any 2008 AMT tax liability if you sell the stock **on or before December 31, 2008**. Please check with us if you have exercised incentive stock options during 2008 and the price of the stock has fallen since the date of exercise. A sale of the stock after December 31, 2008 will not affect your AMT liability for 2008. So, we must act timely for a sale to reduce 2008 taxes!

New Sunset Dates for Provisions Impacting Primarily Businesses. The following *selected* tax breaks impacting primarily businesses now have the following expiration dates:

Selected Expiring Tax Provisions Extended Through The End Of 2009: **1)** 15-Year (instead of 39-Year) Depreciation Recovery Period for Qualified Leasehold Improvements; **2)** 15-Year (Instead of 39-Year) Depreciation Period for Qualified Restaurant Improvements; **3)** Various Tax Incentives for Investing in the District of Columbia; **4)** Favorable S Corporation Charitable Contribution Provisions; **5)** Enhanced Charitable Contribution Rules for Qualifying Business Entities Contributing Computer Equipment, and Book and Food Inventory; and **6)** Extension of Increased Rehabilitation Credit for Structures in the Gulf Opportunity Zone. **Planning Alert!** *Qualified leasehold* and *qualified restaurant* improvements to an existing building [i.e., **items 1) and 2)**, above] may also qualify for the temporary 50% bonus depreciation under the previously-enacted *2008 Economic Stimulus Tax Act*, provided the improvements are **acquired and placed in service during 2008**. **Tax Tip.** If your business is making capital improvements to an existing leased commercial building or a restaurant building, obtaining a "certificate of occupancy" for the **building by December 31, 2008** should satisfy the "placed in service" rule. Please call us if you need a rundown on the types of capital expenditures that will be considered "qualified leasehold" or "qualified restaurant" improvements to an existing building.

Research and Experimentation (R&E) Credit Extended and Modified. The *2008 Stabilization Act* generally extends the R&E credit for qualifying expenditures **through 2009** (previously scheduled to expire at the end of 2007). Historically, there were two methods for computing the R&E credit: **1)** the "regular credit" method, and **2)** the "alternate incremental credit" method. **Starting in 2007**, Congress added a third "alternative simplified credit" method, based on a 12% rate as applied to qualified research expenses. The *2008*

Stabilization Act increases the new *alternative simplified credit* from 12% to 14% **for tax years ending after 2008**, and repeals altogether the *alternative incremental research credit* **for tax years beginning after 2008**. These rules are technical and complex. Please contact us if your business is incurring research expenditures and we will help you determine if you may benefit from the research credit.

OTHER PROVISIONS IMPACTING PRIMARILY INDIVIDUAL TAXPAYERS

Enhanced Refundable Child Tax Credit (For 2008 Only). If your income does not exceed certain thresholds, you may be entitled to a \$1,000 child tax credit even if the credit exceeds your Federal income tax liability. **For 2007**, you were entitled to this *refundable* credit to the extent of 15% of your earned income in excess of \$11,750. The *2008 Stabilization Act* reduces the earned income threshold **for tax years beginning in 2008** to \$8,500. **Planning Alert!** This reduction of the earned income threshold is only for 2008. **Tax Tip.** For 2008, if you have one qualifying child, you need earned income of at least \$15,167 (down from \$18,417 for 2007) to qualify for the full \$1,000 refundable credit.

Requirements For Qualifying Child Tweaked. For **tax years beginning after December 31, 2008**, the *2008 Stabilization Act* makes several changes for a taxpayer to obtain certain tax benefits for a qualifying child (e.g., earned income tax credit, \$1,000 child credit, dependency exemption). For example, under the new law, for certain tax benefits, a *qualifying child* must be younger than the claiming taxpayer, and a taxpayer (other than the child's parent) claiming the child must have higher AGI than the parents of the *qualifying child*. **Tax Tip.** These changes will now allow the *earned income tax credit* (EITC) for a qualifying older sibling who is caring for a younger sibling in a home with no parents, which was denied under prior law due to a technical glitch. **Planning Alert!** These changes will also eliminate the opportunity under prior law for high-income parents with several children to shift tax breaks to one of their lower-income children.

Extended Tax Break For Discharge Of Qualified Home Mortgages. Responding to the sub-prime lending crisis, in late 2007, Congress created a new tax break for certain homeowners who confront home foreclosures, or are engaged in a home mortgage work-out. Generally, any debt you owe that is forgiven or reduced by a lender is taxable to you as "debt discharge income," unless you are insolvent or in bankruptcy. The previously-enacted *2007 Debt Relief Act* added a new exception to debt discharge income. **Effective for discharges of indebtedness after 2006**, if you have a discharge of "qualified principal residence indebtedness," you will not be required to recognize debt discharge income (even if you are neither insolvent nor in bankruptcy). "Qualified principal residence indebtedness" includes up to \$2,000,000 of home acquisition indebtedness which generally includes only debt where the loan proceeds were used for the **1)** acquisition, **2)** construction, or **3)** improvement of your principal residence. This provision was scheduled to expire at the end of 2009; however, the *2008 Stabilization Act* has now **extended it 3 years through 2012**. **Tax Tip.** This provision is particularly helpful if your principal residence is under foreclosure, or your lender has agreed to reduce your home mortgage balance as part of a loan restructuring. If you find yourself experiencing either of these situations, please call our office and we will help you determine whether you qualify for this new tax break.

Basis Reporting By Securities Brokers. Generally **effective for specified securities acquired after 2010**, brokers will be required to report to the IRS the basis and the long or short term holding periods of covered securities disposed of by a customer.

OTHER PROVISIONS IMPACTING PRIMARILY BUSINESS TAXPAYERS

New 15-Year Write Off For Capital Improvements To Qualifying Buildings (2009 Only). The *2008 Stabilization Act* allows a *temporary* 15-year depreciation recovery period (instead of 39 years) for the following two new categories of depreciable realty *placed in service* **after 2008, and before 2010**: **1)** qualified retail improvement property, and **2)** qualified restaurant property. **Planning Alert!** Neither of these properties will qualify for the 50% bonus depreciation that is available **only for 2008**.

Qualified Retail Improvement Property generally includes improvements **1)** made to the interior portion of a **commercial building** (i.e., non-residential real property), **2)** placed into service **more than 3 years after** the building was **first** placed into service, and **3)** made to a building, the interior portion of which is open to the general public **for the sale of tangible personal property**. **Planning Alert!** The following expenditures will not qualify: improvements that enlarge the building; any elevator or escalator; any structural component benefiting a common area; and any cost relating to the internal structural framework of the building.

Qualified Restaurant Property generally includes any improvement to a building, if more than 50% of the building's square footage is devoted to the preparation of, and seating for, on-premises consumption of prepared meals. **Planning Alert!** If qualified restaurant property is placed into service **before 2009**, the qualifying improvements will qualify for the 15-year write-off period (instead of 39 years) *only if* the improvements relate to a building first placed in service at least 3 years before the improvements were placed in service. Therefore, only the qualifying improvements, and not the building itself, will qualify for the 15-year write off. **Tax Tip.** Under the *2008 Stabilization Act*, if the qualified restaurant property is **placed in service in 2009**, it will qualify for the 15-year write off without regard to the 3-year rule. Therefore, if a newly-constructed qualifying restaurant building is **placed into service in 2009**, the *entire* cost of the building will qualify for the 15-year write off.

Planning Alert! If you are currently making capital improvements that might constitute *qualified* retail improvement property or restaurant property, or you are purchasing a restaurant building, it may save you taxes to postpone the placing of the building in service until **2009**. This will allow you to write off these capital improvements over 15 years (rather than 39 years). **Be Careful!** If the improvements are being made to a building under a commercial lease (i.e., a qualifying leasehold improvement), or to a restaurant building that is over 3 years old, you may want to place the improvements in service no later than **December 31, 2008** in order to qualify for the temporary 50% first-year bonus depreciation (provided by the Economic Stimulus Act of 2008). **Caution!** The rules dealing with improvements to leased commercial buildings, buildings used for retail, and buildings used as restaurants are extremely tricky and time sensitive. Furthermore, the depreciation rules become even more complicated if you are planning to do a cost segregation study where you break out non-structural components of a building for depreciation purposes. Please call our firm if you are acquiring, constructing, or improving a building and we will help you devise a strategy that will provide the most rapid write-offs.

Certain Farming Business Equipment Temporarily Treated as 5-Year Property. The *2008 Stabilization Act* generally allows a 5-year recovery period (instead of the previous 7-year period) for any machinery or equipment (**other than** grain bins, cotton ginning assets, fences, or

other land improvements) which: **1)** is used in a farming business, **2)** the *original use* of which commences with the taxpayer **after 2008**, and **3)** is *placed in service* **before 2010**. You are generally considered in the "farming business" if your business involves the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity.

Certain Losses On Freddie Mac And Fannie Mae Stock May Avoid Capital Loss Restrictions. A large number of banks had huge losses on their Fannie Mae and Freddie Mac preferred stock holdings when the government bailed out those companies. In an attempt to soften the blow of those losses, the *2008 Stabilization Act* treats any losses on sales of Fannie Mae and Freddie Mac preferred stock owned by certain financial institutions (e.g., banks, savings institutions, small business investment companies, and business development corporations) on **September 6, 2008 (or sold between January 1 and September 6, 2008)** as ordinary losses, instead of capital losses.

New Limits on Certain Executive Compensation. The *2008 Stabilization Act* places certain tax limitations and restrictions on executive compensation paid to certain executives employed by financial institutions participating in the Treasury's new Troubled Asset Relief Program (TARP) auctions. For example, for institutions who sell at least \$300 million in assets to the U.S. Treasury under the TARP auctions, there will be expanded golden parachute penalties, and limitations on the tax deductibility of certain executive compensation. These rules are quite technical; please call us if you need additional information.

NEW, ENHANCED, AND EXTENDED ENERGY-RELATED TAX INCENTIVES

Highlights. Under the *Energy Tax Incentives Act of 2005*, Congress created a host of expiring tax breaks for individuals and businesses making qualified investments in energy-efficient property. The *2008 Stabilization Act* expands and extends many of these tax benefits, and also creates several new ones. For example, the Act: **1)** extends the 30% investment tax credit for solar energy property and qualified fuel cell property **through 2016**, **2)** extends the credit for residential solar property **through 2016**, **3)** removes the credit cap (currently \$2,000) for solar electric property installed after 2008 (and allows the credit to be used to offset the AMT after 2007), **4)** establishes a new credit for plug-in electric drive passenger vehicles and light trucks ranging from \$2,500 to \$7,500, which is also available against the alternative minimum tax (AMT), **5)** extends the existing energy-efficient buildings deduction for the cost of energy-efficient property installed in commercial buildings for five years **through December 31, 2013**, and **6)** extends the current credit of up to \$2,000 for energy-efficiency improvements to new homes **through 2009**. These represent only a small sample of the many technical changes that the *2008 Stabilization Act* made to energy-related tax incentives. Please call our firm if you need additional details. **Planning Alert!** Under the technical language of the *2008 Stabilization Act*, the \$500 credit for Energy-Efficient Home Improvements is available for 2007 and 2009, **but not for 2008**.

No Extension of Hybrid Vehicle Tax Credit. One of the most popular energy tax breaks is the credit for hybrid automobiles. This hybrid credit is phasing out for many of the most popular hybrid vehicles (for example, no credits are allowed for Toyota hybrid purchases after **September 30, 2007**, and no credits will be allowed for Honda hybrid purchases after **2008**). The *2008 Stabilization Act* **did not** change the phase-out rules for hybrid vehicle credits.

Tax Tip. The tax credit for qualifying hybrid vehicles manufactured by American companies (i.e., Ford, GM) have not yet begun phasing out, and should be fully available at least through the end of 2008. You can get an updated list of the credit status of all hybrid vehicles by visiting the IRS website at www.IRS.gov and typing in hybrid cars and alternative fuel vehicles.

TAX RELIEF FOR RECENT NATIONAL DISASTER AREAS

The *2008 Stabilization Act* provides a long list of temporary tax relief for individuals and businesses recovering from storms and tornadoes that hit the 10 Midwest states earlier this year, similar to the tax relief previously granted to the Gulf Coast states after Hurricane Katrina.

Certain regions of the following states may qualify: Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska and Wisconsin. The Act also provides many of these breaks to victims of all Federally-declared disasters occurring after Dec. 31, 2007 and before Jan. 1, 2010. Depending on the region, this tax relief includes enhanced casualty loss deductions; a new business write-off for demolition and cleanup and repair; a 5-year carry back for business casualty losses or qualified disaster expenses; bonus 50% first year depreciation; and increased dollar limits for expensing certain business property. In addition, the Act provides more limited tax relief to help victims of Hurricane Ike in Louisiana and Texas. These tax breaks are narrowly targeted and quite specific. Please call our firm if you think you or your business may qualify and we will provide you with more details.

FINAL COMMENTS

Please contact us if you are interested in a tax topic we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes and will gladly discuss any current tax developments and planning ideas with you. Please call us before implementing any planning ideas discussed in this letter, or if you need additional information. Note: The information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

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