

Dear Client:

On October 3, 2008, the massive Emergency Economic Stabilization Act of 2008 (the Act) was signed into law. Understandably enough, most of the commentary about this legislation has focused on the broad economic implications. Relatively little attention has been given to the fact that the Act also includes literally hundreds of federal tax changes that will affect millions of individuals and many businesses, large and small alike. Most, but not all, of the changes are taxpayer-friendly.

This letter briefly summarizes what we think are the most important tax changes. However, we encourage you to contact us for more details because there are many changes that we simply don't have the space to even mention here. Some of them could affect you, family members, or your business.

We will start with changes that affect individuals and their personal returns.

### **Personal Tax Changes**

**One-year AMT "Patch" Has Two Parts.** The Act includes another one-year "patch" to prevent millions of individuals from being hit with the dreaded Alternative Minimum Tax (AMT) for the 2008 tax year. As in previous years, the patch has two parts.

1. *Expanded AMT Exemption Amounts.* Without this part of the patch, the AMT exemption amounts for 2008 would have been drastically lower than the amounts for 2007. The Act provides exemptions that are slightly larger. When your 2008 Form 1040 is prepared, these exemptions will be subtracted from income in calculating the amount (if any) that will be taxed under the AMT rules. Here are the expanded exemptions for 2008:

- \$69,950 if you're a married joint-filer or a surviving spouse (up from \$66,250 for 2007).
- \$46,200 if you're unmarried (up from \$44,350).
- \$34,975 if you use married filing separate status (up from \$33,125).

Unfortunately, these exemptions are phased-out for higher-income taxpayers, and the new law doesn't make any changes in the phase-out rule.

2. *Personal Tax Credits Can Reduce AMT Liabilities.* The second part of the patch allows you to offset your AMT amount with designated personal tax credits, which reduces the odds that you will actually owe the AMT for 2008. This favorable provision applies to the following tax credits:

- Child credit (up to \$1,000 per child).
- Hope Scholarship education credit (up to \$1,800) and Lifetime Learning education credit (up to \$2,000).
- Child and dependent care credit.
- Adoption credit.
- Credit for certain energy-efficient items installed in your home.
- Retirement saver's credit.
- Credit for elderly and disabled individuals.
- Mortgage credit.
- First-time DC homebuyer credit.

**Popular Personal Tax Breaks Are Extended.** As expected, Congress extended the following popular personal tax breaks.

- *College Tuition Deduction.* The Act extends for 2008 and 2009 the deduction for up to \$4,000 of college tuition and related fees. If you qualify, you can benefit from this write-off even if you don't itemize.

- *Optional Sales Tax Deduction.* The Act extends for 2008 and 2009 your option to claim an itemized deduction for state and local sales taxes instead of state and local income taxes.
- *Nonitemizer Deduction for Real Property Taxes.* Another law enacted earlier this year established a temporary new real property tax write-off for individuals who don't itemize. Under this provision, you can deduct up to \$1,000 if you're a married joint-filer or up to \$500 if you're not. Originally, the new nonitemizer deduction was only allowed for 2008, but the Act extends it through next year.
- *Teacher Expense Deduction.* The Act extends for 2008 and 2009 the deduction for up to \$250 of personal expenditures made by eligible teachers and school employees to purchase supplies for their schools. If you qualify, you can benefit from this write-off even if you don't itemize.
- *Charitable Donations from IRAs.* If you've reached age 70½ and want to make donations to IRS-approved charities directly out of your IRA, your right to do so has been extended for 2008 and 2009. You can arrange to transfer a total of up to \$100,000 for each year from IRAs that you own. Your spouse can do the same for IRAs that he or she owns. Please contact us if you want to learn more about the tax advantages of making charitable donations in this fashion.
- *Credits for Energy-saving Expenditures for the Home.* The Act extends through 2016 the tax credit for up to 30% of expenditures to install solar electricity generation equipment, solar water heating equipment, and fuel cell equipment in your home. Some favorable changes were made as well. For 2008–2016, you can claim the credit for up to 30% of expenditures for wind energy equipment and geothermal heat pumps. In general, credit amounts for qualifying expenditures are subject to annual dollar caps on each type of expenditure. However, for 2009–2016, there's no longer any cap on the credit for 30% of expenditures for solar electricity generation equipment (before this change, the cap was \$2,000 per year). Finally, this credit can now be used to reduce your AMT liability as well as your regular tax liability, for 2008–2016.
- The Act also restores for 2009 the separate tax credit for installing qualifying energy-efficient insulation, windows, doors, roofs, and heating and cooling equipment in your home. However, this credit was not renewed for 2008. Since the maximum credit is only \$500 reduced by any amounts you claimed in prior years, this is not a big tax-saver. That said, it can be helpful if you qualify.
- *Tax-free Treatment for Forgiven Mortgage Debt Extended through 2012.* Legislation passed at the end of last year allows tax-free treatment for up to \$2 million of forgiven principal residence mortgage debt. The Act extends this provision for three additional years through 2012. Therefore, this provision is now available for qualifying mortgage debt forgiveness transactions that occur in 2007–2012.

**Good News If You Have Unused AMT Credits.** If you generated unused AMT credits in one or more prior years (typically because you exercised some profitable incentive stock options), you may finally be able to turn those unused credits into cash. This is because the new law makes big, and very favorable, changes to the so-called refundable AMT credit rules. While the new provisions are somewhat complicated, the important thing to know is that you can collect 50% of any unused AMT credits generated in pre-2005 years after filing your 2008 Form 1040. You can collect the remaining 50% from pre-2005 years after filing your 2009 return. If you have unused AMT credits generated in 2005 or later, you can also collect them over two years, but you have to wait until they are over three years old to start cashing them in under the new refundable AMT credit rules. Please contact us if you have questions about this very beneficial change.

**Additional Relief for Qualifying AMT Victims.** Another very favorable change expunges unpaid individual AMT liabilities that were outstanding as of 10/3/08 if they were caused by exercising incentive stock options before 2008. Any related interest and penalty charges assessed by the IRS are also wiped away. If you have already paid interest and penalty charges related to such AMT liabilities, you can recover them over two years under the new-and-improved AMT credit rules.

**Higher Personal Casualty Loss Deductible for 2009.** For many years, individuals have had to reduce personal casualty and theft losses by \$100 for each casualty or theft event. The total amount of losses remaining for the year after applying the deductible rule is then reduced by 10% of your adjusted gross income for that year. You can claim any amount left after these two reductions as an itemized deduction on Schedule A of Form 1040. The Act increases the \$100 per-event deductible to \$500, but only for the 2009 tax year. After that, the longstanding \$100 per-event deductible will once again apply.

**New Tax-free Fringe Benefit for Bicycle Commuters.** Starting next year, the Act allows employers to give a new tax-free fringe benefit to employees who commute to work on bicycles. Specifically, an employer can give tax-free reimbursements to cover amounts an employee pays to buy, improve, repair, or store a bicycle that is regularly used to commute to work. However, the amount that can be reimbursed tax-free under this provision is limited to \$20 for each month of bicycle commuting. So, the maximum annual tax-free reimbursement is \$240.

**More-generous Refundable Child Credit Rule.** For qualifying lower-income individuals, the government will refund all or part of the \$1,000 per-child tax credit that remains after the credit has been used to reduce that year's federal income tax bill to zero. Generally, the refundable amount is limited to the lesser of: (1) 15% of earned income in excess of the applicable threshold for the year or (2) the amount of credit left over after the tax bill for the year has been zeroed out. The Act lowers the earned income threshold for 2008 from \$12,050 to \$8,500, which will mean bigger credit refunds for some individuals.

### **Business Tax Changes**

The new law also includes many tax changes that can potentially impact businesses. Here are quick summaries of the ones we think are most likely to affect small and medium-sized operations.

**15-year Depreciation Rule for Leasehold Improvements and Restaurants Extended and Expanded.** The Act extends for 2008 and 2009 the favorable 15-year straight-line depreciation provision for qualified leasehold and restaurant building improvements. In addition, restaurant buildings themselves can now be eligible for the 15-year depreciation rule (for qualified buildings placed in service in 2009).

**New 15-year Depreciation Rule for Retail Space Improvements.** Under a new provision, favorable 15-year straight-line depreciation is allowed for qualified retail improvements placed in service in 2009, but only for improvements put into use more than three years after the building itself was placed in service. The new 15-year depreciation privilege is not available for improvements related to: (1) building enlargements, (2) elevators or escalators, (3) structural components that benefit common areas, or (4) the internal structural framework of a building.

**New Five-year Depreciation Rule for Farming Equipment.** The Act includes a new rule that permits five-year depreciation for qualifying assets used in farming. Absent this change, these assets generally would be depreciated over seven years. Only new (not used) assets placed in service during 2009 are eligible for the five-year depreciation break, and it's not allowed for grain bins, cotton ginning assets, or fencing and other land improvements.

**Research Credit Is Extended and Modified.** The new law extends the research tax credit for qualified expenses paid or incurred in 2008 and 2009. However, the option of claiming the alternative incremental research credit will no longer be available for tax years beginning after 2008, and the alternative simplified research credit rate is increased to 14% for tax years ending after 2008.

**Banks Get Favorable Treatment for Losses from Fannie Mae and Freddie Mac Preferred Stock.** The Act allows favorable ordinary loss treatment for losses when eligible financial institutions sell certain Fannie Mae or Freddie Mac preferred shares. Eligible taxpayers include (among others) banks, savings and loans, and bank and savings and loan holding companies. Shares that qualify for ordinary loss treatment are generally defined as preferred shares in Fannie Mae or Freddie Mac that: (1) were held by an eligible financial institution on 9/6/08 or (2) were sold by an eligible financial institution between 1/1/08 and 9/6/08. Without this change, financial institution losses from selling Fannie Mae and Freddie Mac preferred shares generally would be categorized as capital losses (which face strict limitations on deductibility).

**Enhanced Deduction for Charitable Food Donations Is Extended.** The new law extends for 2008 and 2009 the enhanced charitable donation deduction for non-C corporation businesses that contribute food to charity. Deductions are normally limited to the lesser of: (1) the basis of the food or (2) fair market value. The enhanced deduction equals the lesser of: (1) basis plus one-half the value in excess of basis or (2) two times the basis.

**New Break for Charitable Food Donations by Farmers and Ranchers (12/31/08 Deadline).** The Act includes a special short-term break for charitable donations of food by qualified farmers and ranchers. The donations must occur between 10/3/08 and 12/31/08. Deductions for such donations can be as much as 100% of the taxpayer's adjusted gross income. Excess deductions can be carried forward for 15 years. If a nonpublicly traded corporation is a qualified farmer or rancher, deductions for food donations between 10/3/08 and 12/31/08 can be as much as 100% of the corporation's taxable income (calculated before any deductions for charitable donations). Excess deductions can be carried forward for 15 years.

**Enhanced C Corp. Deduction for Book Donations Is Extended.** The new law extends for 2008 and 2009 the enhanced charitable contribution deduction for C corporation donations of books to qualified schools. The enhanced deduction equals the lesser of: (1) basis plus one-half the value in excess of basis or (2) two times the basis.

**Enhanced C Corp. Deduction for Computer Donations Is Extended.** The Act extends for 2008 and 2009 the enhanced charitable contribution deduction for C corporation donations of computer equipment and related technology to educational organizations and libraries. The enhanced deduction equals the lesser of: (1) basis plus one-half the value in excess of basis or (2) two times the basis. Items must be donated within three years after the corporation acquired them new or built them.

**Provision to Encourage S Corp. Donations of Appreciated Property Is Extended.** The new law extends for taxable years beginning in 2008 and 2009 a special stock basis rule that applies when an S corporation contributes appreciated long-term gain property to charity. Under the special rule, an owner's basis in his or her S corporation stock is only reduced by his or her share of the corporation's basis in the donated property (rather than his or her share of the fair market value of the donated property). This provision is helpful to shareholders because it leaves them with higher basis in their S corporation stock.

**FUTA Tax Surcharge Is Extended.** For the last few years, the Federal Unemployment Tax Act (FUTA) has imposed a 6.2% tax rate on the first \$7,000 of each employee's wages. That 6.2% rate is due to a .2% "temporary" surtax. The Act extends the surtax through 2009, which means the 6.2% rate will continue for another year.

**First-year Expensing for Environmental Remediation Costs Is Extended.** The Act extends for 2008 and 2009 the provision allowing businesses to immediately deduct qualified environmental remediation expenses for sites designated as contaminated areas by appropriate state agencies in the year when they are paid or incurred.

**Favorable Exception for Percentage Depletion from Marginal Oil and Gas Wells Is Restored for 2009 (but not 2008).** The new law reinstates for tax years beginning in 2009 the suspension of the 100%-of-net-income limitation on percentage depletion deductions from marginal oil and gas properties. This favorable change will result in higher depletion deductions for some taxpayers. However, the suspension of the net-income limitation was not reinstated for tax years beginning in 2008.

**Domestic Production Deduction Frozen for Oil-related Income.** For tax years beginning after 2009 and beyond, the percentage rate for the domestic production activities deduction (commonly called the "Section 199 deduction") is slated to rise from the current 6% to 9%. However, the Act reduces the otherwise allowable deduction for post-2009 years by 3% of the least of the taxpayer's: (1) oil-related qualified production activities income, (2) qualified production activities income, or (3) taxable income calculated without the Section 199 deduction (or modified adjusted gross income calculated without the deduction for individual taxpayers). This change is intended to effectively freeze the Section 199 deduction rate at the current 6% level for oil-related income.

## Big Change for Investors (Starting in 2011)

Under today's rules, securities brokers must provide information returns to their customers and copies to the IRS after securities are sold. Specifically, gross sales proceeds must be reported on Forms 1099-B, but that's it. Changes included in the Act will eventually require brokers to calculate gains and losses, classify them as short-term or long-term, and report this additional information to both investors and the IRS. However, this expanded reporting requirement won't kick in until the following dates:

- January 1, 2011: For corporate stock and mutual fund shares.
- January 1, 2012: For shares for which the use of an average basis method is allowed (for example, mutual fund shares acquired in different blocks).
- January 1, 2013: For other specified securities including notes, bonds, commodity contracts, and whatever other securities and financial instruments are designated by the IRS in forthcoming rules.

**Note:** The Act also extends the brokerage firm deadline for giving Forms 1099-B to investors. The old deadline was January 31 of the year following the year in which transactions occur. The new deadline is February 15, and this new deadline applies to Forms 1099-B due after 2008. The next deadline for your brokerage firm Forms 1099-B will be 2/15/09 rather than 1/31/09.

## Problem with Preparer Penalty Is Fixed

The new law changes the standard that tax preparers must generally meet to avoid being hit with IRS penalties on tax understatements attributable to their clients taking certain controversial positions on returns and refund claims. This favorable change applies to returns and claims prepared after 5/25/07. Previously, tax preparers generally had to meet a much stricter standard than clients had to meet to avoid IRS penalties, which created awkward situations. Now, the same penalty-avoidance standard generally applies to both tax preparers and their clients, which is good news for all concerned.

## Changes Affecting Energy Tax Breaks

The Act includes a host of extended, modified, and new tax breaks for energy-related expenditures. Here are the highlights.

**Business Energy Credit Is Extended and Expanded.** The new law extends through 2016 the existing business energy tax credit for qualifying solar, fuel cell, micro-turbine, and certain geothermal energy equipment. Qualified small wind energy equipment and geothermal heat pump systems placed in service after 10/3/08 are added to the list of property eligible for the credit. Finally, the credit is allowed to offset the taxpayer's AMT liability for tax years beginning after 10/3/08.

**New Personal and Business Credit for Plug-in Electric Vehicles.** The Act establishes a new tax credit for plug-in electric vehicles, for qualifying vehicles purchased in tax years beginning after 2008. However, they must be purchased by no later than 12/31/14. The credit amount is \$2,500 for a vehicle powered by a battery with a capacity of at least 4-KW hours. An additional credit of \$417 is allowed for each additional KW hour of battery power until the credit reaches a cap of \$7,500. However, for heavy vehicles weighing over 10,000 pounds, the credit cap can go up to \$15,000. This new credit is allowed for both individual and business taxpayers, but it will be phased out after 250,000 qualifying vehicles have been sold in the U.S. The credit is allowed against the AMT for individual taxpayers.

**Credit for Building Energy-efficient Homes Is Extended.** The new law extends the \$2,000 tax credit for a contractor that builds a new energy-efficient home in the U.S. for one year through 2009. The contractor must sell the home by no later than 12/31/09 for use as a residence to qualify for the credit.

**Deduction for Making Commercial Buildings Energy-efficient Is Extended.** The Act extends for five more years the existing provision allowing immediate deductions for the cost of qualified energy-saving improvements to commercial buildings. The deduction is now available for qualified energy-efficient commercial building property placed in service through the end of 2013.

**Credit for Manufacturing Energy-efficient Appliances Is Extended.** The new law extends and modifies the credit for manufacturing qualifying energy efficient dishwashers, washing machines, and refrigerators. The credit is now available for appliances manufactured through 2010. Presumably, credit amounts are passed along to consumers to a greater or lesser extent.

**And Much, Much More.** The Act includes other tax incentives to encourage expenditures for energy-efficient equipment as well as incentives for the electricity generation and transmission industries.

### **Disaster-relief Tax Changes**

**Liberalized Personal Casualty Loss Deduction for Itemizers.** Normally, you can only claim an itemized deduction for personal casualty losses when they exceed 10% of adjusted gross income (AGI). The Act suspends the 10%-of-AGI deduction floor for net disaster losses, which are defined as the excess of disaster-related personal casualty losses over personal casualty gains of any type. (Casualty gains may occur when you receive insurance proceeds in excess of your basis in property that is damaged, destroyed, or stolen.) This favorable provision only applies to losses due to disasters occurring before 2010 in areas designated as federally declared disaster areas after 2007 (generally losses occurring in 2008 or 2009). The normal rules apply to other personal casualty losses.

**New Casualty Loss Deduction for Nonitemizers.** The new law allows an individual who doesn't itemize deductions to claim an additional standard deduction amount equal to his or her net disaster loss (defined earlier). This favorable provision only applies to net personal casualty losses in federally declared disaster areas. This favorable provision only applies to losses due to disasters occurring before 2010 in areas designated as federally declared disaster areas after 2007 (generally losses occurring in 2008 or 2009).

**Longer Carryback for Disaster-related Net Operating Losses.** An individual or business entity can have a net operating loss (NOL) for a year when allowable deductions and losses exceed income. The Act allows NOLs attributable to qualified disaster losses to be carried back for five years. This can allow eligible taxpayers to collect refunds of taxes paid in the carryback years. This favorable provision only applies to losses due to disasters occurring before 2010 in areas designated as federally declared disaster areas after 2007 (generally losses occurring in 2008 or 2009).

**Liberalized Rules for Businesses.** The Act provides the following disaster tax breaks for businesses:

- An immediate business deduction (rather than capitalization when capitalization would otherwise be required) is allowed for certain disaster-related expenditures made in connection with a business or business-related assets due to a federally declared disaster. This favorable provision only applies to losses due to disasters occurring before 2010 in areas designated as federally declared disaster areas after 2007 (generally losses occurring in 2008 or 2009).
- A 50% first-year bonus depreciation is allowed for qualifying property placed in service after 2007 due to disasters that occur before 2010 in areas designated as federally declared disaster areas after 2007 (generally disasters occurring in 2008 or 2009).
- Enhanced Section 179 deduction rules apply to qualifying property placed in service after 2007 due to disasters that occur before 2010 in areas designated as federally declared disaster areas after 2007 (generally disasters occurring in 2008 or 2009).

### **Conclusion**

Even though this letter is too long, we have not even scratched the surface. We have not mentioned many tax changes that fall into the business, energy, and disaster-relief categories, and there are also changes regarding tax-exempt bonds, tax-credit bonds, tax-exempt organizations, and excise taxes. Since we know you don't want to read a whole book here, we ask you to contact us if you want additional information or if you have questions. We will be pleased to help.

Very truly yours,