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TAX CHANGES AFFECTING INDIVIDUALS AND BUSINESSES FROM THE 2008 FINANCIAL BAILOUT

Several tax law changes, specifically, those resulting from passage of the Emergency Economic Stabilization Act of 2008 (the "Bailout Bill") were signed into law last month. These changes, together with the extension of several other popular tax benefits were included in the Bailout Bill to win support from reluctant lawmakers. Although most of these tax changes impact a relatively small group of taxpayers, we want to bring to your attention the changes likely to impact you as you prepare your 2008 return.

Alternative Minimum Tax Relief

Changes in the alternative minimum tax ("AMT") rules will provide relief for millions of individuals. The initial change increased the exemption amounts that are subtracted from an individual's "alternative minimum taxable income" to determine the taxable amount (if any). The exemption amounts for 2008 are $69,950 for joint filers, $46,200 for single filers, and $34,975 for married taxpayers filing separate returns. These amounts, although only slightly higher than in 2007, are substantially higher than the exemption amounts originally scheduled to apply in 2008.

The second broadly applicable AMT change allows taxpayers to use all their "nonrefundable personal credits" (e.g., the dependent care credit) in full to offset both the regular tax and the AMT in 2008. Prior to this change, which represents a one-year extension of a rule that had expired in 2007, the majority of the nonrefundable personal credits could not be utilized to offset the AMT.

Other changes in the new law are aimed at a narrower but nevertheless substantial group of taxpayers. These involve the many employees who paid AMT as a result of exercising incentive stock options ("ISOs"), then later suffered losses on selling the stock after its value had declined sharply. This scenario is often called the "phantom income" problem because tax is paid on gains that never materialize. The new law addresses this problem in two ways. First, it liberalizes a rule, which originally took effect in 2007, designed to allow taxpayers to recover some of the benefit of previously unused AMT credits over

The Closely Held Business Team attorneys at Harrang Long Gary Rudnick are committed to serving the needs of business owners in a responsive and proactive manner. They understand the challenges and the opportunities provided by the law in today's business climate, and are focused on the advancement of each client's success in business.

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a five-year period. The new law provides additional relief by eliminating a phase-out provision in the original rule and reducing the recovery period to two years.

Second, the new law forgives any tax, including interest and penalties, outstanding on October 3, 2008 (date of enactment), if attributable to the minimum tax adjustment for ISOs. Second, for taxpayers who have already paid any interest and penalties that would have been abated under this new rule, such interest and penalties can be used—half in 2008 and half in 2009—to increase the "AMT refundable credit amount" and the minimum tax credit.
Another AMT change may benefit energy-conscious taxpayers. Beginning in 2008, the credit for "energy efficient residential property" can be used to offset the AMT.

Retroactive Extensions of Other Individual Provisions

The new law extends several provisions through 2009 that had expired at the end of 2007. These include:

• **State and Local Sales Tax Deduction**. Allows taxpayers to use state and local sales taxes as itemized deductions in lieu of state income taxes.

• **Deduction for Qualified Tuition and Related Expenses**. Allows an "above-the-line" deduction (i.e., not part of itemized deductions) for certain higher education expenses. The maximum deduction is $4,000 or $2,000, depending on the taxpayer's adjusted gross income (AGI). No deduction is allowed for single filers having AGI above $80,000 or for joint filers having AGI above $160,000.

• **Tax-free IRA Distributions to Charity**. Permits direct distributions to charity of up to $100,000 from a traditional or Roth IRA maintained for an individual who has reached age 70 ½. Ordinarily, such distributions would be taxable to the individual, who would not be able to offset the income fully because of the percentage limitations on charitable contribution deductions.

Principal Residence/Vacation Home Sale

The Code currently provides a $250,000 exclusion ($500,000 on joint returns) of gain on the sale of a principal residence when the taxpayer has used the home as a primary residence for two of the preceding five years. For any period the home is not used as a primary residence after 12/31/08, such nonqualified use period is ineligible for the gain exclusion. For example, if you purchase a vacation home in January 2009, start using it as your principal residence in 2012, and sell it two
years later, only 40% of the gain is eligible for exclusion. The recognized gain due to nonqualified use periods is generally taxed at the capital gains rate.

Purchase Business Equipment and Obtain Additional Depreciation/Expensing Benefits

As part of the economic stimulus, investment in new equipment has been encouraged by expanding the amount of new equipment that may be expensed in the year acquired and placed in service rather than merely taking a depreciation expense over the expected life of the asset. For 2008, businesses are now permitted to expense $250,000 of depreciable personal property, such as machinery, equipment, and furniture acquired by purchase for use in the active conduct of a trade or business. This $250,000 expense limit is phased out if the purchases exceed $800,000 in 2008. The expense limit is reduced to $125,000 in 2009, inflation indexed for 2010, and reduced to $25,000 in 2011.

Within these accelerated expense rules, there is a separate limitation for certain listed vehicles. The vehicle limits have also been increased for 2008 to allow a taxpayer to claim this first year expense up to $10,960 on a new auto mobile used in business and $11,960 on a light truck or van.

Credit for Residential Energy Efficient Property Extended and Expanded

The new law extends through 2016 the credit for "residential energy efficient property," which was scheduled to expire at the end of 2008. Also, as noted above, beginning in 2008, taxpayers can use the credit against the alternative minimum tax ("AMT"). Moreover, the new law retroactively adds two new types of qualifying property, and, beginning after 2008, removes the credit limit for "qualified solar electric property."

Previously, the credit was based on expenditures for three defined types of qualifying property: qualified solar electric property, qualified solar water heating property, and qualified fuel cell property. The new law adds two more categories: qualified small wind energy property and qualified geothermal heat pump property. The credit for each type of property is 30% of qualifying expenditures, subject to a dollar limit for each. These limits are as follows:

- $2,000 for qualified solar electric property expenditures in 2008; the limit is removed after 2008.
- $2,000 for qualified solar water heating property expenditures.
- $2,000 for qualified geothermal heat pump property expenditures.
- $500 for each half kilowatt of capacity (not to exceed $4,000) for qualified small wind energy property expenditures.
- $500 for each half kilowatt of capacity for qualified fuel cell property expenditures.

Earned Income Threshold for Child Tax Credit Refundability

The new law reduces the earned income threshold for determining the refundability of the child tax credit for 2008 to $8,500 (from $12,050).

Real Property Tax Deduction for Nonitemizers

In 2008, individuals who do not itemize their deductions may include, as part of the standard deduction, real property taxes of up to $500 ($1,000 for joint filers). The new law extends this rule through 2009.

If you have questions concerning whether any of these or other benefits passed in recent legislation impacts you or your business, please contact our closely held business members Randall L. Duncan or Jonathan D. Mishkin, LL.M. at (503) 242-0000, and we will be glad to assist you.

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