



BDO Seidman, LLP
Accountants and Consultants

Subject:
**Principal Tax Provisions in
the Emergency Economic
Stabilization Act of 2008**

Federal Tax Alert

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For more information, please contact:

Jack Frame
Director – National Tax Office
330 Madison Avenue
New York, NY 10017
Direct: (212) 885-8125
Cell: (973) 714-6301
jframe@bdo.com

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Summary:

On October 3, 2008, the President signed into law H.R. 1424, the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343 (the “Act”). The Act, originally introduced in the House to address the current economic crisis, was expanded to include a substantial number of other tax provisions. This Tax Alert will describe the principal tax provisions of the Act.

Discussion

In mid-September, the Administration proposed legislation that would, if enacted, authorize a program to provide liquidity to banks and other financial institutions. Under this program, a federal agency would purchase troubled assets of these institutions to allow them to make new loans to borrowers. The legislation introduced in the House of Representatives included only a small number of tax provisions directly related to the troubled assets relief program (“TARP”). On Monday, September 29, the House rejected this bill. However, the Senate subsequently took up the legislation, but added two more “divisions” to the bill containing a variety of tax provisions from other pending legislation. The Senate approved this expanded bill on Wednesday, October 1, and the House approved the same bill on Friday, October 3. The President signed the bill within hours after it passed the House.

The Act thus has three separate divisions, each of which bears its own title, as follows:

- Division A, the Emergency Economic Stabilization Act of 2008
- Division B, the Energy Improvement and Extension Act of 2008
- Division C, the Tax Extenders and Alternative Minimum Tax Relief Act of 2008

The entire Act includes well over 100 separate tax provisions. This Tax Alert will discuss only those provisions expected to have broad impact across a large number of taxpayers.

Alternative Minimum Tax Relief

The individual alternative minimum tax (“AMT”) includes a few well-known structural flaws, which threaten to subject increasing numbers of taxpayers to the tax each year. Congress has responded with a series of one-year “patches” in order to keep the number of taxpayers subject to the AMT relatively constant from year to year. The components of individual AMT relief are as follows:

1. **Increase in Exemption Amounts.** The exemption amounts are not indexed for inflation in the same manner as many of the features of the regular income tax. The Act increases the exemption amounts, for 2008 only, to reflect an inflation adjustment from the 2007 levels. The exemption amounts are \$69,950 for returns of married taxpayers filing jointly and certain surviving spouses, and \$46,200 for single taxpayers and heads of households. The exemption amount for married individuals filing separate returns is \$34,975.
2. **Nonrefundable Personal Credits.** The Act extends to 2008 the ability of individuals to use nonrefundable personal credits against both regular tax and AMT liability. The affected credits include the child tax credit, credit for adoption expenses, the dependent care credit, the Hope and lifetime learning credits, and the credits for certain residential energy efficient property.
3. **Refundable AMT Credits.** Individuals had previously been able to claim, as a refundable credit, a percentage of their long-term (more than three taxable years) unused minimum tax credit, subject to a phase-out based on the income of the taxpayer. This credit is scheduled to expire at the end of 2012. Beginning in 2008, the Act increases the specified percentage from 20 percent to 50 percent and removes the income limitations on the use of the credit.
4. **AMT ISO Relief.** Individual taxpayers may have incurred AMT as the result of the exercise of incentive stock options. For AMT purposes, the exercise of the option is a taxable event, but for regular tax purposes, the exercise of the option is generally not a taxable event. The Act contains an abatement of any AMT for a pre-2008 taxable year that is attributable to the exercise of such an option and remains unpaid as of October 3, 2008, as well as the abatement of any related interest and penalties. Additional relief is available, in the form of a refundable AMT credit, for interest and penalties previously paid as the result of an ISO exercise which are not eligible for abatement.

Extension of Individual Expiring Tax Provisions

The Internal Revenue Code contains a substantial number of provisions which, when enacted, are set to expire after the passage of one or more years. These expiring provisions have been enacted, and may continue to be enacted, as temporary provisions because of congressional concerns over the revenue “cost” of making them permanent, because of questions about their long-term effectiveness, or in order to affect taxpayer behavior in the short term. The following provisions, primarily affecting individuals, were extended by the Act:

1. **Itemized Sales Tax Deduction.** Individuals may elect to claim their state and local general sales taxes as an itemized deduction in lieu of a deduction for state and local income taxes. This deduction is particularly useful for individuals residing in states with no individual income taxes. This deduction has been extended for 2008 and 2009 taxable years.

2. Tuition and Related Expenses Deduction. Subject to income limitations, an individual may claim an above-the-line deduction for certain qualified tuition and related fees. This deduction has been extended for 2008 and 2009 taxable years.
3. Property Tax Deduction for Non-Itemizers. An individual who does not itemize deductions may increase the standard deduction by the first \$500 of property taxes paid (\$1,000 in the case of a joint return). Originally enacted for 2008 only, the Act extends the deduction to the 2009 taxable year.
4. Tax-Free IRA Distributions for Charitable Purposes. An individual retirement account may make limited distributions to charitable organizations without such distributions being included in the gross income of the beneficiary. The beneficiary is not entitled to a charitable contribution deduction for the amount of the distribution. This treatment has been extended for 2008 and 2009 taxable years.

Extension of Business Expiring Tax Provisions

Approximately 25 expiring business tax provisions were extended, generally through December 31, 2009. The principal business tax provisions receiving an extension are as follows:

1. Research and Development Tax Credit. The credit for increasing research expenditures has been extended, but with modifications. The alternative incremental research credit is repealed for taxable years beginning after December 31, 2008. The rate applicable to the alternative simplified credit is increased from 12 percent to 14 percent for taxable years ending after December 31, 2008.
2. Subpart F Exception for Active Financing Income. Exclusions from the application of the subpart F inclusion rules have been provided for certain insurance income of controlled foreign corporations (“CFC”s), as well as for income derived from the active conduct of a banking, finance, or similar business of such corporations. The exclusion now applies to taxable years of CFCs that begin before January 1, 2010, and to corresponding taxable years of United States shareholders.
3. Related CFC Payments. Another subpart F exclusion is available for dividends, interests, rents, and royalties received or accrued by one CFC from another related CFC, to the extent that the income is not attributable to subpart F income of the related CFC or to income of the related CFC effectively connected with the conduct of a trade or business in the United States. This exclusion also now applies to taxable years of CFCs that begin before January 1, 2010, and to corresponding taxable years of United States shareholders.
4. Depreciation of Leasehold Improvements, Restaurant and Retail Improvements. Qualified leasehold improvements and certain restaurant property may be depreciated as 15-year recovery property if placed in service before January 1, 2010, but only under the straight-line method. A new category of 15-year, straight-line property is also created for certain qualified retail improvement property placed in service during the calendar years 2008 and 2009.
5. Brownfields Expensing. Taxpayers may elect to deduct, rather than capitalize, certain Brownfields remediation costs paid or incurred before January 1, 2010. Such costs must be of a type that are otherwise required to be capitalized, and may not relate to a contaminated site on the “national priorities list” under federal environmental laws.

6. Railroad Maintenance Tax Credit. A 50-percent credit is available for certain qualified railroad track maintenance expenditures paid or incurred before January 1, 2010, in connection with a Class II or Class III railroad.
7. Charitable Contribution Incentives. Favorable tax treatment is extended for two years in the case of (a) charitable contributions of appreciated property by S corporations; (b) certain contributions of computer technology and equipment; and (c) certain contributions of food and book inventories.

Provisions Relating to Troubled Assets Relief Program

1. Ordinary Losses on Certain Preferred Stock. Many banks and other financial institutions held preferred stock in the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”). Because of events affecting Fannie Mae and Freddie Mac, it is likely that this preferred stock will either be sold at a loss or be considered worthless. The taxpayers holding such preferred stock generally do not have other sources of capital gains, because gains and losses from a broad category of debt instruments are treated as ordinary gains and losses. Subject to certain limitations, banks and other financial institutions (including their holding company parents) will be allowed to treat losses from the sale or exchange (including worthlessness) of Fannie Mae and Freddie Mac preferred stock as ordinary losses.
2. Executive Compensation Limitations for TARP Participants.
 - (a) Existing Tax Law Restrictions. Two existing federal tax law provisions attempt to limit compensation by establishing quantitative limits on compensation deductions. The section 162(m) provisions impose a \$1 million annual limitation on the deduction for compensation paid to executive officers of public companies whose compensation is required to be disclosed under Securities and Exchange Commission rules. Certain performance-based compensation is exempt from this deduction limitation. In addition, section 280G precludes a deduction for excess parachute payments, defined as the excess of payments in the nature of compensation contingent on a change of control of the corporation (or a substantial portion of its assets) over the base amount. The base amount is generally the average annualized includible compensation over a five-year base period. No amount of compensation is subject to section 280G if the total amount of such parachute payments made to an individual does not exceed three times the base amount of that individual. If section 280G applies, the individual is also subject to a 20-percent excise tax under section 4999.
 - (b) Two Aspects of TARP. The Act contemplates that troubled assets may be acquired by two different methods under the TARP. In general, it is expected that such assets will be purchased and sold through a “market” or “auction” mechanism. However, if such a mechanism is not considered feasible or appropriate, a direct purchase of such assets may be made by the Treasury Department Office of Financial Stability. Direct purchases will result in the imposition on the institution of substantive provisions regarding corporate governance and executive compensation. Fewer substantive restrictions will be imposed on institutions participating through the market mechanisms. Instead, sections 162(m) and 280G will be expanded so as to impose new or more restrictive limitations on these institutions.
 - (c) Expansion of Tax Law Provisions. These expanded provisions apply to any “applicable employer” that sells more than \$300 million of troubled assets in the aggregate, pursuant to the

TARP, for the current and all prior taxable years. These tax law restrictions will not apply to any person that participates in the TARP only through direct purchases, as their compensation will be limited by contract (or otherwise) with the Office of Financial Stability. Section 162(m) is applied, in the case of these employers, by (1) reducing the \$1 million limitation to \$500,000, (2) eliminating the exception for commissions and performance-based compensation, (3) extending its application to non-public companies and to non-corporate entities, and (4) extending its application to deferred compensation that may not be deducted until a subsequent taxable year. Section 280G is applied, in the case of these employers, by (1) extending its application to the covered executives described in section 162(m) (as modified by the Act), (2) extending its application to payments made by reason of the involuntary termination of the executive or the bankruptcy, insolvency, or receivership of the employer (even if there is no change in control), (3) extending its application to non-corporate employers, and (4) eliminating exceptions for reasonable compensation, for small business corporations, and for non-public corporations that meet certain shareholder disclosure and approval requirements.

3. Individual Cancellation of Indebtedness Income Relief. Individuals may avail themselves of the favorable treatment for income from cancellation of indebtedness with respect to the discharge of certain qualified principal residence indebtedness. The taxpayer does not need to be insolvent, nor does the discharge need to occur in a title 11 (bankruptcy) case. However, the taxpayer must reduce the basis of the residence by the amount of the discharge. This provision, first enacted in late 2007, has been extended for three years, such that it now applies to discharges occurring before January 1, 2013.

Revenue-Raising Provisions

1. “Offshore” Nonqualified Deferred Compensation. The largest single revenue-raising provision in the Act is a provision that adds section 457A and will impose current taxation on nonqualified deferred compensation from tax indifferent parties. Such compensation is includible in the taxable year in which there is no substantial risk of forfeiture of the rights to such compensation. If the amount of the compensation is not determinable at the time it is otherwise includible, the compensation may included in the subsequent taxable year in which it becomes determinable. However, the tax for the subsequent year must be increased by an interest charge and by 20 percent of the includible compensation. This provision applies to compensation from two types of employers: (a) foreign corporations, other than a corporation substantially all of whose income is either effectively connected with the conduct of a trade or business in the United States or subject to a comprehensive foreign tax, and (b) partnerships (whether foreign or domestic) unless substantially all of the partnership’s income is allocated to persons other than tax-exempt organizations and foreign persons not subject to a comprehensive income tax.
2. Broker Reporting of Customer Securities Basis. Brokers will be required to include in their information reporting requirements relating to a sale of the security the amount of a customer’s adjusted basis in that security, and whether any gain or loss is a long-term or short-term gain or loss. These provisions generally do not apply until January 1, 2011, and apply only to securities acquired on or after that date. The effective date is further delayed until 2012 for mutual funds, and until 2013 for securities other than stock.
3. Section 199 Deduction for Oil and Gas. The section 199 deduction relating to qualified production activities income is scheduled to increase from six percent to nine percent for taxable years beginning after 2009. This deduction effectively reduces a taxpayer’s rate of tax on such income

from 35 percent to slightly less than 32 percent. In the case of income from the production, refining, processing, transportation, or distribution of oil, gas, or primary products thereof, the deduction is effectively frozen at six percent.

4. Foreign Oil and Gas Income. For purposes of the foreign tax credit, the different treatment of foreign oil and gas extraction income and foreign oil related income is eliminated for taxable years beginning after December 31, 2008.
5. Extension of FUTA Surtax. An additional 0.2 percent federal unemployment tax on the first \$7,000 of wages was in effect through 2008, making the total tax rate 6.2 percent. That additional tax is extended through the end of the calendar year 2009.

Energy-Related Provisions

The energy-related provisions are too numerous to list or describe. These provisions generally are classified into four different categories: (1) renewable energy incentives; (2) carbon mitigation and coal provisions; (3) transportation and domestic fuel security provisions; and (4) conservation and energy-efficiency provisions.

Other Miscellaneous Provisions

1. Tax Return Preparer Penalty Revisions. Changes made by Congress to the tax return preparer penalty provisions in May 2007 increased the comfort level at which preparers must be in order to avoid imposition of penalties on return preparers. In general, a penalty could be imposed if the preparer did not have a reasonable belief that the tax treatment was not more likely than not the proper treatment with respect to an undisclosed position, or if a disclosed position did not have a reasonable basis. In the case of an undisclosed position, this standard was higher than the standard applicable to taxpayers themselves, *i.e.*, taxpayers needed to be at least at substantial authority. The Act retroactively reduced the comfort level needed for preparers to avoid a penalty relating to undisclosed positions so that it conforms to the taxpayer standards, *i.e.*, there must be at least substantial authority for an undisclosed position. The Act retained the higher (more likely than not) preparer-penalty comfort level needed for tax shelters, listed transactions, and certain other tax-avoidance-motivated reportable transactions, retained the increased scope of the preparer penalty standards (beyond income tax returns), and also retained the increased monetary penalties.
2. Refundable Child Tax Credit Modifications. Certain low-income taxpayers may claim a refundable child tax credit based on the extent to which their earned income exceeds a specified threshold amount. For 2008, the threshold amount would have been \$12,050, reflecting inflation adjustments from a statutory \$10,000 base. The Act reduces that threshold to \$8,000 for 2008 only, thus permitting an increased refundable credit for affected taxpayers.
3. Disaster Relief Provisions. The Act makes several types of tax relief or other tax benefits available as the result of the Midwest storms and flooding and Hurricane Ike. In addition, similar provisions are made available for 2008 and 2009 to future disasters that may occur in federally declared disaster areas.