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CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

On October 3, 2008, the President signed H.R. 1424: Emergency Economic Stabilization Act, commonly known as “the bailout bill”. While the Act’s primary purpose is to solve the credit crunch in our financial markets, it is also one of the largest tax bills in recent years, with almost 300 changes to the tax code, more than \$150 billion in tax breaks for individuals and businesses and \$42 billion in tax increases for certain targeted groups.

The tax provisions are contained in three separate Divisions of the Act:

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 AMT Relief Act of 2008

A summary of the tax-related provisions follows. If you would like more details about these changes or any other aspects of the new law, or would like to discuss how these changes affect you or your business, please do not hesitate to contact the Sensiba San Filippo tax team.

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2008 Extenders Act - individual and business extenders and other relief provisions

The “Tax Extenders and Alternative Minimum Tax Relief Act of 2008” (the “2008 Extenders Act”), provides extensions for several popular tax breaks and the addition of several new relief provisions, including disaster area tax relief. The following is an overview of the key provisions in the new legislation:

Deduction of state and local general sales taxes. The option to deduct state and local general sales taxes is extended through 2009.

Qualified tuition deduction. The above-the-line tax deduction for qualified higher education expenses is extended through 2009.

Teacher expense deduction. The provision allowing teachers an above-the-line deduction for up to \$250 for educational expenses is extended through 2009.

IRA rollover provision. The provision allowing qualified taxpayers to make tax-free contributions from their IRA plans to qualified charitable organizations is extended through 2009.

Additional standard deduction for real property taxes. The standard deduction for real property taxes for non-itemizers is extended through 2009.

Research and development credit. The research tax credit is extended through 2009. In addition, the alternative simplified credit is increased from 12% to 14% for the 2009 tax year, and the alternative incremental research is repealed for the 2009 tax year.

15-year straight-line cost recovery for qualified leasehold, restaurant, and retail improvements. The 15-year write-off for qualified leasehold, restaurant and retail improvements is extended through 2009.

Basis adjustment to stock of an S corporation making charitable contributions of property. Favorable Subchapter S basis rules for gifts of appreciated property are extended through 2009.

Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico. The provision allowing a Section 199 domestic production activities deduction for activities in Puerto Rico is extended through 2009.

Other extended provisions. Other provisions extended through 2009 include:

- Qualified zone academy bonds.
- Indian employment credit.
- Accelerated depreciation for business property on Indian reservation.
- Tax credit for certain expenditures for maintaining railroad tracks.
- 7-year recovery period for certain motor sports racetrack property.
- Work opportunity tax credit for Hurricane Katrina employees.
- New markets tax credit.
- Increased rehabilitation credit for structures in the Gulf Opportunity Zone.
- Enhanced charitable deduction for qualified computer contributions.
- Tax incentives for investments in the District of Columbia.
- Enhanced charitable deduction for food inventory.
- Enhanced charitable deduction for contributions of book inventory to schools.
- Special expensing rules for certain film and television productions.
- Exception under Subpart F for active financing income.

Revenue raisers. The new legislation offsets the cost of the tax break extensions by requiring hedge fund managers and others to account for deferred compensation (income held in offshore accounts and other corporate structures) as it accrues, rather than avoiding appropriate and timely income taxes.

Additional tax relief provisions. In addition to the extensions of tax relief described above, the 2008 Extenders Act also includes liberalizations for the child tax credit, income averaging for Exxon Valdez litigation amounts, a 5-year write-off for certain farming equipment, and a change in the standards for imposition of the tax return preparer penalty.

Disaster relief. Included in the new legislation is Midwestern disaster area tax relief for victims of the disaster in Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska and Wisconsin, and a new tax relief package for victims of all Federally-declared disasters occurring after Dec. 31, 2007 and before Jan. 1, 2010 (e.g., eased loss deduction rules, a new business writeoff for demolition, cleanup and repair, a 5-year carryback for casualty losses or qualified disaster expenses, bonus 50% first year depreciation for property placed in service through Dec. 31, 2011 (Dec. 31, 2012 for real property), and increased expensing dollar limits).

2008 Extenders Act - AMT relief

The “Tax Extenders and Alternative Minimum Tax Relief Act of 2008” (the 2008 Extenders Act), contains provisions that extend partial relief to individual taxpayers from the alternative minimum tax, or AMT. Earlier temporary measures to deal with the unintended creep of the AMT's reach expired at the end of 2007, meaning that more than 20 million additional taxpayers would have faced paying the tax on their 2008 returns without the new relief.

Brief overview of the AMT.

The AMT is a parallel tax system which does not permit several of the deductions permissible under the regular tax system, such as state, local and property taxes. Taxpayers who may be subject to the AMT must calculate their tax liability under the regular federal tax system and under the AMT system taking into account certain “preferences” and “adjustments.” If their liability is found to be greater under the AMT system, that's what they owe the federal government. Originally enacted to make sure that wealthy Americans did not escape paying taxes, the AMT has started to apply to more middle-income taxpayers, due in part to the fact that the AMT parameters are not indexed for inflation.

In recent years, Congress has provided a measure of relief from the AMT by raising the AMT “exemption amounts”—allowances that reduce the amount of alternative minimum taxable income (AMTI), reducing or eliminating AMT liability. (However, these exemption amounts are phased out for taxpayers whose AMTI exceeds specified amounts.)

For 2007, the AMT exemption amounts were \$66,250 for married couples filing jointly and surviving spouses; \$44,350 for single taxpayers; and \$33,125 for married filing separately. However, for 2008, those amounts were scheduled to fall back to the amounts that applied in 2000: \$45,000, \$33,750, and \$22,500, respectively. This would have brought millions of additional middle-income Americans under the AMT system, resulting in higher federal tax bills for many of them, along with higher compliance costs associated with filling out and filing the complicated AMT tax form.

New law provides one-year stopgap fix.

To prevent the unintended result of having millions of middle-income taxpayers fall prey to the AMT, Congress has once again relied on a temporary “patch” to the problem, this time a one-year extension of the 2007 exemption amounts, increased slightly. Under the new law, for tax years beginning in 2008, the AMT exemption amounts are increased to: (1) \$69,950 in the case of married individuals filing a joint return and surviving spouses; (2) \$46,200 in the case of unmarried individuals other than surviving spouses; and (3) \$34,975 in the case of married individuals filing a separate return.

Personal credits may be used to offset AMT through 2008.

Another provision in the new law provides AMT relief for taxpayers claiming personal tax credits. The tax liability limitation rules generally provide that certain nonrefundable personal credits (including the dependent care credit, the elderly and disabled credit, and the Hope Scholarship and Lifetime Learning credits) are allowed only to the extent that a taxpayer has regular income tax liability in excess of the tentative minimum tax, which has the effect of disallowing these credits against AMT. Temporary provisions had been enacted which permitted these credits to offset the entire regular and AMT liability through the end of 2007. The new law extends this temporary provision to tax years beginning in 2008.

Extension and modification of AMT credit allowance against incentive stock options (ISOs).

A further provision in the new law liberalizes the AMT refundable credit amount that was first enacted in 2006 to help taxpayers who were stung by the AMT as a result of exercising incentive stock options (ISOs). Under the regular tax, ISOs are not taxed upon exercise. Under the AMT, however, a taxpayer must pay tax on the stock value when the option is exercised. 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. In 2006, Congress provided relief for these situations but did not correct the problem entirely.

The new law provides additional relief to affected taxpayers by accelerating the refund of taxes paid on the phantom income and by stopping further IRS efforts to collect those taxes. Specifically, the new law allows 50% of long-term unused minimum tax credits to be refunded over each of two years (instead of 20% over each of five years as was allowed under pre-2008 Extenders Act law), eliminates a rule that limited the relief available to higher-income taxpayers, and abates any underpayment of tax outstanding on the date of enactment related to ISOs and the AMT including interest.

2008 Extenders Act - Charitable extenders and new incentives

The Tax Extenders and Alternative Minimum Tax Relief Act of 2008 extends several expired charitable giving tax breaks and provides several new tax incentives for charitable giving.

Charitable giving provisions extended for two years.

Several popular charitable incentives expired at the end of 2007 and would not have been available to taxpayers on their 2008 tax returns if Congress had not acted. The new law restores the provisions and extends them for two years (through 2009). The extended provisions include:

- ***IRA charitable rollover.*** This provision allows individuals aged 70 1/2 and older to donate up to \$100,000 from their individual retirement accounts (IRAs) and Roth IRAs to public charities without having to count the distributions as taxable income. This giving incentive is particularly beneficial to those individuals who do not itemize their tax deductions and would not otherwise receive any tax benefit for their charitable contributions.
- ***Enhanced charitable deduction for food inventory.*** This provision allows businesses to claim an enhanced deduction for the contribution of food inventory. The new law also eliminates the percentage limitation for contributions made by certain farmers and ranchers after Dec. 31, 2007, but before Jan. 1, 2009.
- ***Enhanced charitable deduction for contributions of book inventory to schools.*** This provision allows C corporations an enhanced charitable deduction for donations of books to schools, public libraries and literacy programs.
- ***Enhanced charitable deduction for qualified computer contributions.*** This provision encourages businesses to contribute computer equipment and software to elementary, secondary, and post-secondary schools by allowing an enhanced deduction for such contributions.
- ***Basis adjustment to stock of S corporations making charitable contributions of property.*** Under this provision, if an S corporation makes a contribution to a charity the amount of a shareholder's basis reduction in the S corporation stock will be equal to the shareholder's pro rata share of the adjusted basis of the contributed property (rather than the pro rata share of the fair market value of the contribution, as was the case under prior law).

New tax incentives for charitable giving.

New incentives for charitable giving contained in the new legislation include:

- ***Temporary suspension of limitations on charitable contributions.*** The amount allowed as a charitable deduction in any year may not exceed ten percent of the corporation's taxable income or fifty percent of an individual's adjusted gross income. The new law temporarily waives these limits regarding charitable cash contributions dedicated to Midwestern disaster relief efforts. The provision is effective for contributions paid during the period beginning on the earliest applicable disaster date for all States and ending on Dec. 31, 2008.
- ***Increase in standard mileage rate for charitable use of vehicles.*** The mileage rate individuals may use to compute a tax deduction for personal vehicle expenses associated with charitable work is statutory and has not been increased since 1997 and is currently at 14 cents per mile. For a taxpayer assisting in relief efforts related to the Midwestern disaster, the new law sets the charitable mileage rate at seventy percent of the current standard business mileage rate, beginning on the applicable disaster date and ending on Dec. 31, 2008.
- ***Exclusion from income of mileage reimbursements for charitable volunteers.*** In general, reimbursements received for operating expenses of a personal vehicle used in connection with charitable work in excess of the statutory charitable mileage rate are taxable income to the recipient. However, reimbursements for charitable mileage attributable to the Midwestern disaster up to the amount of the standard business mileage rate will not be considered taxable income through Dec. 31, 2008.

2008 Economic Stabilization Act - Mortgage debt relief extension, tax relief for community banks, partial crackdown on executive compensation

The Emergency Economic Stabilization Act of 2008 provides: (1) an extension for home mortgage debt forgiveness relief, (2) tax relief for community banks that invested in Fannie Mae and Freddie Mac preferred stock, and (3) a tax crackdown on compensation and severance pay for certain financial executives. Here are the key details regarding those provisions.

Two-year extension of home mortgage debt forgiveness relief provision. The new law provides assistance to homeowners who have been caught in the current mortgage crisis and are trying to save their homes. Under 2007 tax legislation, taxpayers are generally allowed to exclude up to \$2 million of mortgage debt forgiveness on their principal residence. However, this relief provision was scheduled to expire at the end of 2008. Under the new law, this debt relief provision is extended through 2012.

To understand the importance of this relief provision, one needs to know that for income tax purposes, a discharge of indebtedness—that is, a forgiveness of debt—is generally treated as giving rise to income that's includible in gross income. Under pre-2007 tax law, there were no special rules applicable to discharges of acquisition debt on the taxpayer's principal residence.

For example, assume a taxpayer who wasn't in bankruptcy and wasn't insolvent owned a principal residence subject to a \$200,000 mortgage debt for which the taxpayer had personal liability. The creditor foreclosed and the home was sold for \$180,000 in satisfaction of the debt. Under pre-2007 tax law, the debtor had \$20,000 of debt discharge income. The result was the same if the creditor restructured the loan and reduced the principal amount to \$180,000. In 2007 the tax laws were temporarily changed to allow taxpayers to exclude up to \$2 million of mortgage debt forgiveness on their principal residence.

Assuming the same facts as in the foregoing example except that the discharge occurs in 2008. In that case the debtor has no debt discharge income when the creditor (1) restructures the loan and reduces the principal amount to \$180,000 or (2) forecloses with the result that the \$200,000 debt is satisfied for \$180,000. However, this debt relief provision was scheduled to expire at the end of 2009. The new legislation extends the provision through 2012. The relief is not extended to home equity loans.

Tax relief for community banks. Some 800 community banks had huge losses on their Fannie Mae and Freddie Mac preferred stock holdings which became worthless when the government bailed those companies out. Without a tax change, these community banks would have had capital losses on these holdings that they couldn't utilize. The new legislation allows community banks to treat losses on their Fannie Mae and Freddie Mac preferred stock as ordinary losses that can offset ordinary income. Applying to any preferred stock that was owned on Sept. 6, 2008, or sold between Jan. 1, 2008, and Sept. 6, 2008, this provision allows banks to claim the book benefit of the loss on their tax returns, thereby reducing their need to obtain additional capital from the FDIC or investors.

Tax crackdown on compensation and severance pay for certain financial executives. Under the new law, when more than \$300 million of a company's assets are purchased by the Treasury through an auction, (1) "golden parachute" payments are banned for top executives hired while the Treasury rescue is in effect and (2) tax provisions kick in to strengthen the tax treatment of remaining executive compensation and severance packages. Specifically, the deductibility of executive compensation for companies will be cut in half from pre-Act levels, and companies will also lose deductions available under pre-Act law for excessively large severance packages. Executives receiving severance packages will continue to face a 20% excise tax on payments once they reach an excessive threshold, and that tax will be due if the executive leaves for reasons other than a standard retirement for which they are eligible—not just if the company changes hands, as in pre-Act law.

2008 Energy Improvement and Extension Act - Solar and wind incentives for homeowners

Congress has given a generous boost to homeowners who want to convert their homes to solar energy or cut their electricity bills with a wind turbine. The “Energy Improvement and Extension Act of 2008” (the 2008 Energy Act) contains tax breaks for homeowners who invest in a home solar-power system or small wind turbine. These tax breaks, when combined with incentives that already exist in many states, mean that homeowners may be able to get back a sizeable portion of their investment in such projects from the government. The 2008 Energy Act also includes a package of energy-related tax incentives designed to spur investment and create jobs in the renewable energy industry.

Solar tax credit extended and enhanced. Under pre-2008 Energy Act law, homeowners were eligible for tax credits for qualified solar water heating and photovoltaic systems. Solar water heating systems produce hot water; photovoltaic systems produce electricity. The credits, which were available for systems placed in service between Jan. 1, 2006 and Dec. 31, 2008, were for 30% of the cost of the system. For individuals the maximum credit was \$2,000 for photovoltaic systems and \$2,000 for solar water heating systems in any tax year.

The new law makes several improvements on the previous rules. First, it extends the credit for an additional eight years (through 2016). Second, it scraps the \$2,000 cap, which didn't go far with most solar installations. The \$2,000 cap meant that a homeowner who installed a \$40,000, 5-kilowatt rooftop system could get only \$2,000 back through the tax break. Under the new law, that same homeowner receives a \$12,000 (30% × \$40,000) tax cut.

With similar or even more generous incentives available in many states, that means that a homeowner will often be able to get more than half the investment in a home solar-power system back from the government. A third improvement under the new law is that the tax credit is made applicable against the alternative minimum tax (AMT). Under pre-2008 Energy Act law, an individual could not use the credit to reduce his income tax below the level at which the AMT kicked in. The new law allows the credit to be used to offset the AMT.

The new law also contains another important provision for solar enthusiasts that allows utilities to take advantage of a production tax credit for solar projects, making it more likely that they will invest directly in them.

Tax credit for small wind turbines. It has long been argued by wind energy proponents that high up-front costs were preventing homeowners and businesses from installing small wind systems on their property to generate electricity, and that a federal tax credit for small wind turbines similar to the solar tax credit should be provided to encourage more taxpayers to undertake such projects.

The new law responds to these arguments by creating a 30% credit on the installed cost of small wind turbines (defined as those with rated capacities of 100 kilowatts or less) for residential or commercial applications. The credit, which is capped at \$4,000, applies to wind turbines placed in service through 2016.

To give an idea of the value of such a credit, industry sources report that a typical 10-kilowatt residential wind turbine costs about \$32,000 and takes about 15 years to pay for itself in terms of lowered electricity costs. The new credit, by shaving \$4,000 off the up-front cost of the turbine, should reduce the payback period of the project. In addition, the new law allows the credit to be used to offset the AMT.

Long-term extension and modification of the residential energy-efficient property credit. The credit for residential solar property is extended through 2016, and the credit cap (\$2,000 under pre-2008 Energy Act law) for solar electric investments is removed. Residential small wind investment, capped at \$4,000, and geothermal heat pumps, capped at \$2,000, are added as qualifying property. The credit may be used to offset the AMT.

Plug-in electric drive vehicle credit. Consumers could collect a tax credit of \$2,500 to \$7,500 for the purchase of a plug-in electric car or light truck, depending on the capacity of the battery. The credit is available against the AMT. The base-line credit will be \$2,500 for vehicles powered by a 4-kilowatt hour battery. (By way of comparison, the current Toyota Prius stores 1.3 kilowatt hours.) An additional \$417 will be added for each kilowatt hour of battery power beyond that, up to a total limit of \$7,500 for light-duty vehicles (up to \$15,000 for vehicles weighing more than 26,000 pounds).

Extension of credit for energy-efficiency improvements to new homes. The provision allowing contractors to receive a credit for the construction of energy-efficient new homes is extended through 2009.

Bicycle commuters. Employers are allowed to provide employees who commute to work by bicycle limited fringe benefits to offset the costs of such commuting (e.g., storage).

Long-term extension of energy credit. The 30% investment tax credit for solar energy property and qualified fuel cell property, as well as the 10% investment tax credit for microturbines, are extended through 2016. The cap for qualified fuel cells is increased, and small commercial wind is added as a category of qualified investment. A new 10% investment tax credit is provided for combined heat and power systems and geothermal heat pumps. These credits may be used to offset the alternative minimum tax (AMT).

Extension and modification of production tax credit. The renewable energy production tax credit is extended through 2009 in the case of wind and refined coal, and through 2010 in the case of other sources. The types of facilities qualifying for the credit are expanded to include new biomass facilities and those that generate electricity from marine renewables (e.g., waves and tides).

Carbon capture and sequestration demonstration projects. The new law provides \$1.5 billion in new tax credits for the creation of advanced coal electricity projects and certain coal gasification projects that demonstrate the greatest potential for carbon capture and sequestration technology.

CO2 capture credit. The new law provides a credit of \$10 per ton for the first 75 million metric tons of CO2 captured and transported from an industrial source for use in enhanced oil recovery and \$20 credit per ton for CO2 captured and transported from an industrial source for permanent storage underground.

Expansion of allowance for cellulosic biofuels property. The provision allowing taxpayers to immediately write off 50% of the cost of facilities that produce cellulosic biofuels is expanded to include production of other cellulosic biofuels in addition to cellulosic ethanol.

Extension of biodiesel production tax credit; extension and modification of renewable diesel tax credit. The \$1.00 per gallon production tax credit for biodiesel and the 10¢/gallon credit for small biodiesel producers are extended through 2009. The \$1.00 per gallon production tax credit for diesel fuel created from biomass is also extended. Biodiesel imported and sold for export is not eligible for the credit effective May 15, 2008.

Extension and expansion of the alternative refueling stations credit. The 30% credit for alternative refueling property, such as natural gas or E85 pumps, is extended through 2010. Electric vehicle recharging property is added to the types of property eligible for the credit. The credit for hydrogen refueling property is unchanged.

Percentage depletion for marginal wells. The suspension on the taxable income limit for purposes of depreciating a marginal oil or gas well is extended for 2009.

Extension and modification of credit for energy-efficiency improvements to existing homes. The tax credit for energy-efficient existing homes is extended for 2009 and is expanded to include energy-efficient biomass fuel stoves as a new class of energy-efficient property eligible for a consumer tax credit of \$300.

Extension of energy-efficient buildings deduction. The law allowing taxpayers to deduct the cost of energy-efficient property installed in commercial buildings is extended through 2013.

Modification and extension of energy-efficient appliance credit. The provision allowing manufacturers to receive a tax credit for the production of energy-efficient appliances is extended through 2010, and the credit's standards and amounts are increased.

Accelerated depreciation for smart meters and smart grid systems. The depreciable life of such property is reduced from 20 years to 10 years.

Investments in recycling. Taxpayers can claim accelerated depreciation for purchases of equipment used to collect, distribute or recycle a variety of commodities.

Revenue raisers. The energy changes are offset by: mandatory basis reporting to IRS by brokers on transactions involving publicly traded securities; freezing the Code Sec. 199 manufacturing deduction at 6% (the deduction had been scheduled to increase to 9% in 2010 under pre-2008 Energy Act law) for domestic manufacturing activities of major American oil and gas companies; extending the FUTA surtax through 2010; tightening the rules by which oil and gas companies pay taxes on income earned overseas; and making general fund monies available with increased payments into the oil spill liability trust fund as new drilling is considered.