CORDASCO
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2008

INCOME TAX DEVELOPMENTS

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RECENT TAX LEGISLATION

We are witnessing legislative tax changes at an unprecedented pace. Responding to a fragile economy, Congress has enacted no less than six 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).** As 2008 is rapidly coming to a close, 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, and much more!

Additionally, 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.

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.

> **Planning Alert!** We highlight only selected provisions of recent legislation. If you have heard or read about any provision not discussed in this information, please call our office. We will help you determine how the provision impacts you or your business. This information 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.

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INTRODUCTION

Since late December, 2007, President Bush has signed into law the following six 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*) and **6)** Emergency Stabilization Act of 2008 *(2008 Stabilization Act)*. Collectively, these tax bills are designed to restore liquidity to the financial markets, provide tax relief for homeowners and home buyers in an ailing housing market, generate an economic stimulus to help jump-start the economy, 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 certain 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), and a new tax on U.S. citizens who receive certain gifts from expatriates. 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.

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. 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 70½; and **6)** Increased Charitable Deduction Limits for Qualifying Conservation Easements.

- **Alternative Minimum Tax (AMT) Relief Extended Through 2008.** Without the new legislation, 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 new legislation 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 new legislation: **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 new legislation 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 new legislation 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 new legislation 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.

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.

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.
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> **Planning Alert!** You will **not qualify** for the credit if you purchase your home from a related party (e.g., certain family members).
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> **Tax Tip.** Your *principal residence* could include a condominium, houseboat, or mobile home.
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> **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 ($7,500/15 years) to his or her tax liability starting with the 2010 tax return, and ending with the 2024 tax return.
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> **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.
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> **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.

Tax Tip. 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.

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 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.

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 payment.

Tax Tip. If your rebate check turns out to be greater than your actual 2008 credit, you can keep the excess! Also, the IRS says the stimulus payment is not taxable income.

Planning Alert! You should keep your IRS 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*.

> **Tax Tip.** 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.

New SECA Tax Relief For Retired Farmers. The *2008 Farm Act* provides that, **effective for payments made after 2007**, self-employed social security (SECA) tax will no longer be imposed on Conservation Reserve Payments (CRPs) to individuals who are receiving Social Security retirement or Social Security disability payments. Please call us if you need additional information.

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.

NEW TAX RELIEF FOR MILITARY PERSONNEL

The **Heroes Earnings Assistance and Relief Act of 2008** (2008 Heroes Act) contains tax breaks targeted to servicemen 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. When Congress authorized the economic stimulus payments, it required that no payments could be made to individuals filing joint returns unless each spouse had a valid Social Security number. 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. 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 nor the AGI phase-out rules.

> **Tax Tip.** This gives survivors more choices as to where they can invest these benefits.

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.

> **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

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 lead 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 exclusion. The 2008 Housing Act clamps down on this planning technique for **sales 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**.

> **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.
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> **Planning Alert!** The actual mechanics for applying this new rule can be complicated. Please call us if you need more information on this new limitation.

Renouncing U.S. Citizenship May Now Trigger Taxable Gain. 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.

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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.**
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> **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.

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.
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> **Tax Tip!** IRS says that an option to acquire property is not a binding contract.
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> **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.

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 new property that has a depreciable life for tax purposes of 20 years or less (e.g., machinery and equipment; furniture and fixtures; cars and light general purpose trucks; sidewalks, roads, landscaping, **depreciable computer software).** Also, **certain leasehold improvements** may qualify for the 50% deduction.

  > **Planning Alert!** These are only examples of qualifying property. If you have a question about property that we have not mentioned, call us and we will help you determine if it qualifies.

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. 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.

- **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.

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 is 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! 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 ($20,000/20%).

> **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.

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., nonresidential 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 benefitting 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

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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 nonstructural 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.

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.

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