

Sy Accountancy Corporation

Member, American Institute of CPAs

704 Mira Monte Place, Pasadena, California 91101

Tel (626) 744-0200 • Fax (626) 744-0300 • vsy@victorsycpa.com • www.victorsycpa.com

THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008 (THE BAILOUT PLAN)

By Victor Sy, CPA

As stocks tumbled and credit lines dried up, President Bush submitted a two-page proposal for a bailout plan. The Senate added 100 pages to the plan which the House of Representatives rejected until 400 pages of sweeteners were included in the pot. The **Emergency Economic Stabilization Act of 2008**, popularly referred to as the “Bailout Plan,” was signed by the President on October 3, 2008. If you get frustrated by the complexity of our tax laws, don't blame the IRS.

Financial Bailout-Related Tax Changes

The centerpiece of the new law is, of course, the financial bailout package, that consists of:

1. A three-year extension for home mortgage debt forgiveness relief,
2. Tax relief for banks who may treat losses on Fannie Mae and Freddie Mac preferred stocks as ordinary losses, and
3. A tax crackdown on compensation and severance pay for certain financial executives.

1. Three-Year Extension for Home Mortgage Debt Forgiveness Relief: Taxpayers may exclude up to \$2 million (\$1 million for married individuals filing separately) of mortgage debt forgiveness on their principal residence. Acquisition indebtedness is incurred in the acquisition, construction, or substantial improvement of an individual's principal residence that is secured by the residence. This provision was set to expire 12/31/09. The Act extends it for three additional years through 2013.

2. Tax Relief for Community Banks with Losses on Fannie Mae and Freddie Mac Preferred Stock: Preferred stock issued by Federal National Mortgage Corporation (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) became worthless when the federal government bailed them out. This created not only major financial difficulties for banks, but also tax problems since loss on the disposition of stock is a capital loss. The Bailout Plan allows these losses as ordinary losses.

3A. Deductions for Executive Compensation Limited for Employers Participating in the Bailout: An employer may deduct reasonable comp for personal services as ordinary and necessary. The new law limits to \$500,000 the deductible pay of an executive of an employer from which a troubled asset is acquired under the “troubled assets relief program” (“TARP”).

3B. Severance Pay for Top Financial Executives Subject to Golden Parachute Rules: Under golden parachute rules, a corporation is not allowed a deduction for excess parachute payments to a disqualified individual. In addition, a 20% excise tax on excess parachute payment is imposed. The Act extends the golden parachute rules to executives of employers participating in TARP.

Extension of Personal Tax Breaks

1. The Act also resurrects and/or extends the following personal federal income tax breaks:

- **College Tuition Deduction.** The above-the-line deduction for up to \$4,000 of college tuition and related fees was retroactively restored for 2008 and extended through 2009.
- **Optional Sales Tax Deduction.** The optional itemized deduction for general state and local sales taxes was retroactively restored for 2008 and extended through 2009.
- **Additional Standard Deduction for Property Taxes.** The new standard deduction add-on for state and local real property taxes paid by individuals, who don't itemize, was extended through 2009. This provision allows married joint-filing couples to deduct up to \$1,000 of real property taxes paid during the year. Other taxpayers can deduct up to \$500.
- **Educator Expense Deduction.** The above-the-line deduction for up to \$250 of personal expenditures by teachers and other school employees was retroactively restored for 2008 and extended through 2009.
- **Tax-free Principal Residence Mortgage Debt Relief.** The provision allowing federal-income-tax-free treatment for up to \$2 million of forgiven principal residence mortgage debt was extended for three more years through 2012. Taxpayers need not be bankrupt or insolvent to benefit from this provision.
- **Credit for Residential Solar and Fuel Cell Equipment.** The credit for 30% of expenditures for solar electricity generation, solar water heating equipment, and fuel cell equipment in a U.S. residence, was scheduled to expire at the end of 2008. The Act extends the credit through 2016.
- **Credit for Residential Energy-efficient Improvements.** The separate credit for energy-efficient insulation, windows, doors, roofs, and heating/cooling equipment expired at the end of 2007. The Act restores the credit for 2009 (but not for 2008). Note that the credit is limited to only \$500 over a taxpayer's lifetime, so it's not terribly significant.
- **First-time Homebuyer's Credit.** This credit was retroactively restored for 2008 and extended through 2009.

2. Bigger Refundable Child Tax Credits (For 2008 Only): For lower-income taxpayers, the tax credit of \$1,000 per qualifying child can be a refundable credit. The Act lowers the 2008 earned income threshold from \$12,050 to \$8,500.

3. Personal Casualty Loss Deductible Increased (for 2009 Only): Personal casualty and theft losses must first be reduced by \$100 for each casualty or theft event. The Act increases the \$100 per-event deductible to \$500, but only for tax years beginning in 2009 (none for 2008). After that, the longstanding \$100 per-event deductible will once again apply.

Changes Affecting Business

1. FUTA Tax Surcharge Extended. The Federal Unemployment Tax Act (FUTA) imposes a 6.2% tax rate (a permanent 6% rate plus a .2% "temporary" surtax) on the first \$7,000 of annual wages. The Act extends the .2% surtax through the end of 2009.

2. 15-Year Depreciation Provision for Leasehold Improvements and Restaurants Extended. The 15-year straight-line depreciation for leasehold and restaurant building improvements is restored for 2008 and extended for property placed in service in 2009.

3. New 15-year Depreciation Provision for Retail Space Improvements. The Act includes a new provision that allows 15-year straight-line depreciation for qualified retail improvement property placed in service in 2009.

4. New Tax-free Fringe for Bicycle Commuters. The Act creates a new tax-free transportation fringe benefit for employees who commute to work on bicycles. An employer can provide tax-free reimbursements to cover reasonable expenses to buy and maintain a bicycle that is regularly used for commuting. The amount is limited to \$20 for each month of bicycle commuting.

Changes Affecting Energy Tax Breaks

1. Business Energy Credit is Extended and Expanded. The new law extends through 2016 business energy tax credits for solar, fuel cell, micro-turbine, and geothermal energy equipment. The credit is allowed to offset the taxpayer's AMT liability.

2. New Personal and Business Credit for Plug-in Electric Vehicles. The Act establishes a new tax credit for plug-in electric vehicles from 2009 to 2014. The credit amount is \$2,500 to \$7,500 for a vehicle powered by a battery. This new credit is allowed for both individual and business taxpayers and is allowed against the AMT for individual taxpayers.

3. Credit for Building Energy-efficient Homes is Extended. The new law extends the \$2,000 tax credit for a contractor that builds a new energy-efficient home in the U.S. for one year through 2009.

4. Deduction for Making Commercial Buildings Energy-efficient is Extended. The Act extends existing provision allowing immediate deductions for five more years through 2013.

5. Credit for Manufacturing Energy-efficient Appliances is Extended to 2010. The new law extends credits for manufacturing energy efficient dishwashers, washing machines, and refrigerators. Credits are supposed to be passed along to consumers.

Disaster-Relief Tax Changes

1. Liberalized Personal Casualty Loss Deduction for Itemizers. You can only deduct personal casualty losses when they exceed 10% of adjusted gross income (AGI). The Act suspends the 10% floor for net disaster losses (good for 2008 and 2009).

2. New Casualty Loss Deduction for Nonitemizer. The new law allows an individual who doesn't itemize deductions to claim an additional standard deduction equal to his/her net disaster loss in federally declared disaster areas (good for 2008 and 2009).

3. Longer Carryback for Disaster-related Net Operating Losses. An individual or business entity can have a net operating loss (NOL) for a year when allowable deductions and losses exceed income. The Act allows NOLs attributable to qualified disaster losses to be carried back for five years (good for losses in 2008 and 2009).

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

- An immediate business deduction, rather than capitalization (good for 2008 and 2009).
- A 50% first-year bonus depreciation (good for 2008 and 2009).
- Enhanced Section 179 deduction (good for 2008 and 2009).