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The Emergency Economic Stabilization Act of 2008

An Explanation

By

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The Emergency Economic Stabilization Act of 2008

On October 3, 2008, Congress passed, and President Bush signed into law, the Emergency Economic Stabilization Act of 2008 (the “Stabilization Act” or the “Act”). The Stabilization Act is Congress’s highly publicized response to the recent failure of several high profile financial institutions, as well as the liquidity problems currently facing our financial markets. The most significant provision of the Act is a wide-ranging grant of authority to the Secretary of the Treasury (the “Secretary”) that allows the Secretary to establish a program to purchase up to \$700 billion in troubled assets, primarily mortgage-backed securities, but also any other asset type that the Secretary determines is troubled. As part of the Secretary’s authority, the Secretary is required to establish a pricing mechanism for purchasing troubled assets at a price not above what the seller paid for it. Through this grant of authority to the Secretary, Congress hopes to promote stability in the financial markets.

In addition to authorizing the Secretary to purchase troubled assets, the Stabilization Act contains several other tax and financial provisions that are likely to affect individuals and businesses of all income levels. For example, the Act strengthens the Hope for Homeowners Program, which encourages lenders to minimize foreclosures and provides tools for doing so. The Act also extends, through 2013, the expiration date of current tax law that allows a taxpayer to exclude from their taxable income up to \$2 million of mortgage debt forgiveness. This article outlines notable tax and financial provisions from the Stabilization Act.

Although this article discusses certain tax and financial provisions related to the Secretary’s authority to purchase troubled assets, it does not directly address the full scope of the Secretary’s authority. Other portions of the Stabilization Act, such as the provisions providing additional relief for individuals in disaster areas and the provisions encouraging businesses to invest in efficient and renewable energy sources, affect only a narrow range of taxpayers and are also not discussed in this article.

If you have any questions regarding any of the Stabilization Act changes discussed below or any of the changes not discussed in this article, please contact Al Feit at 301-664-8201 or Kevin Jones at 301-664-8164.

Financial Provisions

Homeownership Preservation

The Stabilization Act encourages efforts to modify mortgages for homeowners facing foreclosure by requiring modification in loans owned by the federal government and strengthening certain homeowner relief programs, most notably the Hope for Homeowners Program. The Hope for Homeowners Program was designed by Congress to help eligible homeowners facing foreclosure work with their lenders to refinance their mortgages into more sustainable loans. The Stabilization Act strengthens the Hope for Homeowners Program by expanding the definition of an eligible homeowner and improving tools to prevent foreclosure

In addition to an expanded Hope for Homeowners program, the Stabilization Act authorizes the Secretary to guarantee loans, facilitate loan modifications, and request loan servicers to avoid preventable foreclosures. The Secretary is also required to consent to reasonable requests to extend the term of mortgages, reduce mortgage rates, reduce principal, and remove other mortgage modifications or limitations.

Increased FDIC Insurance Coverage

To enhance protection of FDIC insured bank deposits, the Stabilization Act grants increased borrowing authority to the FDIC and temporarily increases FDIC insurance coverage. Under the Act, FDIC insurance is temporarily increased from \$100,000 to \$250,000, per depositor. The increased FDIC insurance is scheduled to expire on 12/31/2009.

Mental Health Insurance Parity

For health insurance plan years beginning one year or more after the enactment date, the Stabilization Act requires that, if mental health benefits are offered, the cost-sharing or benefit limits on mental health services be no more restrictive than those imposed on other medical services. This requirement applies only to health insurance plans covering 51 or more employees.

Tax Provisions and Extensions Affecting Businesses

Construction of Energy-Efficient Residential Real Property Tax Credit

Under current law, eligible contractors, including home manufacturers, may qualify for a \$2,000 credit for the construction of energy-efficient homes. An energy-efficient home is one that is certified to have a projected 50 percent reduction in the level of annual heating and cooling energy consumption, as compared to comparable homes, with at least one-fifth of that reduction coming from improvements to the building envelope. The Stabilization Act extends the expiration date of this credit to homes purchased before 12/31/2009.

FUTA Surtax

Under current law, the FUTA tax rate is 6.2 percent, made up of the permanent FUTA rate of 6 percent, plus a temporary .2 percent surtax. The surtax was originally set to expire at the end of 2008, but the Stabilization Act extends the surtax through 2009.

Research and Development Credit

Before the Stabilization Act, the research and development credit, which allows business taxpayers to claim a tax credit for a portion of their research and development expenses, expired on 12/31/2007. The Stabilization Act, however, extends the expiration date of the research and development credit through 12/31/2009.

15-Year Cost Recovery for Qualified Leasehold Improvements

Before the Stabilization Act, taxpayers making improvements to qualified leasehold property could deduct the costs of the improvements using 15-year straight-line depreciation. Qualified leasehold improvement property (non-residential) generally includes interior improvements to a building pursuant to a lease, so long as the improvement is made more than 3 years after the building was first placed in service, but does not include building enlargements, elevator or escalator installation, improvements to structural components benefiting a common area, or improvements to the internal framework of a building. This advantageous depreciation allowance, originally expiring on 12/31/2007, was extended to property placed in service before 1/1/2010. The 15-year cost recovery allowance also applies to certain restaurant and retail property.

Tax Provisions and Extensions Affecting Individuals

Purchase of Residential Energy-Efficient Property Tax Credit

Under current law, an individual taxpayer may claim a credit for the purchase of energy-efficient property to be installed in the taxpayer's real property. The credit is equal to the total of:

- 30 percent of the purchase price for qualified solar energy property, up to \$2,000;
- 30 percent of the purchase price for qualified solar water heating property, up to \$2,000; and
- 30 percent of the purchase price for qualified fuel cell property, up to \$500 for each .5 kilowatt of capacity.

The Stabilization Act extends the residential energy-efficient property tax credit to property placed in service before 2017 and adds several new components to the credit. Notably, the Act removes the \$2,000 limit for qualified solar energy property purchased after 12/31/2008. In addition, the Act increases the types of property that qualify for the credit such that an individual taxpayer may also claim a credit equal to:

- 30 percent of the purchase price of qualified wind energy property, up to \$500 for each .5 kilowatt of capacity; and
- 30 percent of the purchase price of qualified geothermal heat pump property, up to \$2,000.

The Stabilization Act also allows the credit to offset AMT.

Home Mortgage Debt Forgiveness Relief

Under current law, taxpayers may exclude from their gross income up to \$2 million of mortgage debt forgiveness related to their principal residence, so long as the debt is qualified principal residence indebtedness. Qualified principal residence indebtedness is indebtedness incurred to finance the

acquisition, construction, or substantial improvement of an individual's principal residence. Originally, this debt forgiveness relief applied only to indebtedness incurred before 1/1/2010, but the Stabilization Act extends the exclusion through 2013.

Election to Deduct State and Local Sales Tax

Individual taxpayers who itemize their deductions may elect to claim state and local sales tax as a deduction, instead of state local income taxes. The Stabilization Act extends the expiration date of this provision to tax years beginning before 1/1/2010.

Above the Line Deduction for Higher Education Expenses

Individual taxpayers may deduct up to \$4,000 in qualified higher education expenses, subject to certain income limitations, to arrive at adjusted gross income. Although the deduction expired for tax years beginning after 12/31/2007, the Stabilization Act extends the deduction through 2009.

Standard Deduction for State and Local Property Taxes

Under current law, individual taxpayers who do not itemize their deductions may claim an additional standard deduction of up to \$500 (\$1,000 for married individuals filing jointly) for state and local property taxes paid during tax years beginning in 2008. The Stabilization Act extends the additional standard deduction to include tax years beginning in 2009.

Nontaxable IRA Transfers to Charity

Under current law, an individual age 70½ or older may exclude up to \$100,000 from gross income for otherwise taxable IRA distributions that are distributed to qualified charities. Because the distribution is not included in income, the taxpayer may not claim a deduction for the distribution. In addition, such qualified charitable distributions are not subject to the charitable contribution percentage limits. A qualified charitable distribution is one that is made on or after the date the IRA owner turns 70½, directly by the IRA trustee to a charitable organization, and is otherwise a deductible charitable contribution. Before the Stabilization Act, this exclusion provision applied only to tax years beginning in 2006 and 2007. The Act, however, extends this exclusion to tax years beginning before 1/1/2010.

Shareholder Basis Adjustments for Contributions from an S Corporation

Under the Pension Protection Act of 2006, a shareholder's basis adjustment in his S corporation stock for a charitable contribution is equal to his pro rata share of the adjusted basis of the contributed property. Under the Pension Protection Act, this basis adjustment rule applied only for property contributed before 12/31/2007. The Stabilization Act, however, extends the basis adjustment rule to apply to contributions made before 1/1/2010.

New Markets Tax Credit

The new markets tax credit allows taxpayers acquiring stock in a community development entity to claim a credit equal to:

- 5 percent of the amount of the investment in the year of the investment and for each of the two following years (a total of 15 percent of the amount of the investment); and
- 6 percent of the amount of the investment each year for four years after the first three years (a total of 24 percent of the amount of the investment).

The new market tax credit is subject to certain maximum limits on the amount of the credit and is recaptured if the taxpayer does not hold the community development entity stock for seven years. A community development entity is a corporation or partnership that:

- Holds as its primary objective serving or providing investment capital to low-income communities or low-income persons;
- Maintains accountability to residents of low-income communities through their representation on a governing or advisory board; and
- Is certified by the Department of the Treasury as a community development entity.

The new market tax credit, originally expiring on 12/31/2008, is extended by the Stabilization Act through 12/31/2009.

Washington, DC Investment Incentives

The Stabilization Act extends several tax incentives allowed to taxpayers that invest in the District of Columbia. Some of the more notable extensions are listed below:

- The designation of the DC Enterprise Zone is extended through 12/31/2009;
- Washington, DC's authority to issue tax-exempt financing is extended through 12/31/2009;
- The 0 percent capital gains rate for the sale of certain qualified DC Enterprise Zone assets is extended through 12/31/2014; and
- The DC first-time homebuyer credit is extended to include eligible property purchased before 1/1/2010.

AMT Provisions

Increased AMT Exemption

To determine his or her AMT income, an individual begins with taxable income, makes various required adjustments to taxable income, and then subtracts an exemption amount. Prior to the Stabilization Act, the exemption amounts for 2008 were as follows:

- \$45,000 for married individuals filing jointly and surviving spouses;
- \$33,750 for unmarried individuals; and
- \$22,500 for married individuals filing separately.

The Stabilization Act increased the AMT exemption amount to the following levels for 2008:

- \$69,950 for married individuals filing jointly and surviving spouses;
- \$46,200 for unmarried individuals; and
- \$34,975 for married individuals filing separately.

AMT Refundable Credit for Incentive Stock Options (ISOs)

To the extent an individual's deferral adjustments cause his tentative minimum tax to exceed his regular tax in any given year, the individual receives a minimum tax credit (MTC) that can offset regular tax in years when the regular tax exceeds the tentative minimum tax. Before the Stabilization Act, if the taxpayer's MTC was unused after three years (*i.e.*, it has become a "long-term unused MTC"), then a portion of that MTC was refundable against AMT in an amount equal to the greater of \$5,000 or 20 percent of the long-term unused MTC for that tax year, subject to certain AGI phase-out limitations.

Under the Stabilization Act, a taxpayer may claim a refundable credit against AMT for up to 50 percent of the long-term unused MTC for that tax year. Effectively, this allows a taxpayer to use the long-term unused MTC related to any given year over two years, rather than five years. In addition, the AMT refundable credit is increased for 2008 and 2009 by 50 percent of the amount of any interest and penalty paid before the date the Act was enacted due to the AMT adjustment for ISOs.

The Stabilization Act's liberalization of the AMT refundable credit is largely designed to assist taxpayers who were taxed under AMT on the value of their exercised ISOs, but then saw the value of their stock drop quickly and substantially due to the deflation of the tech stock bubble in the early 2000s. As an additional benefit to such taxpayers, the Stabilization Act provides that outstanding underpayments of tax attributable to the minimum tax adjustment for ISOs, including related interest and penalties, are abated.

Nonrefundable Tax Credit Offset Against AMT

Prior to the Stabilization Act, many nonrefundable tax credits for individuals could not be used to offset AMT. With the Stabilization Act, however, Congress expanded the number of credits that may be used to offset AMT by including the following credits:

- The dependant care credit;
- The credit for elderly and permanently and totally disabled individuals;
- The adoption credit;
- The child tax credit;
- The mortgage credit;
- The Hope and Lifetime Learning credits;
- The lower income saver's credit;
- The nonbusiness energy property credit for energy-efficient improvements to a principal residence;
- The residential energy-efficient property credit; and
- The first-time D.C. homebuyer credit.