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Emergency Economic Stabilization Act 2008 Financial Bailout and Tax Package (Enacted Oct. 3, 2008) Overview of Tax Changes Affecting Individuals

Several tax law changes affecting individuals were enacted Oct. 3, 2008. Most of them apply retroactively. These changes, together with several other popular tax benefits, were included in the controversial financial bail-out legislation to win support from reluctant lawmakers.

Although many of the changes will have a modest impact on a relatively small group of taxpayers, they are described below for your general information, as well as their potential applicability. The changes in the alternative minimum tax, however, are likely to have a significant positive impact on your 2008 federal tax picture. These changes are discussed immediately below.

Alternative Minimum Tax Relief

Changes in the alternative minimum tax (“AMT”) rules will provide relief for millions of individuals. The first change is an increase in the exemption amounts that are subtracted from an individual’s “alternative minimum taxable income” to determine the taxable amount (if any). The exemption amounts for 2008 are \$69,950 for joint filers, \$46,200 for single filers, and \$34,975 for married taxpayers filing separate returns. These amounts, although only slightly higher than in 2007, are substantially higher than the exemption amounts originally scheduled to apply in 2008.

The second broadly applicable AMT change permits taxpayers to use all their “nonrefundable personal credits” (e.g., the dependent care credit) in full to offset both the regular tax and the AMT in 2008. Before this change, which represents a one-year extension of a rule that had expired in 2007, most of the nonrefundable personal credits could not be used to offset the AMT.

Other changes in the new law are aimed at a narrower but nevertheless substantial group of taxpayers. These are the many employees who paid AMT as a result of exercising incentive stock options (“ISOs”), then later suffered losses on selling the stock after its value had declined sharply. This scenario is often called the “phantom income” problem because tax is paid on gains that never materialize.

The new law addresses this problem in two ways. First, it liberalizes a rule, which originally took effect in 2007, designed to allow taxpayers to recover some of the benefit of previously unused AMT credits over a five-year period. The new law provides additional relief by eliminating a phase-out provision in the original rule and reducing the recovery period to two years.

Second, the new law forgives any tax, including interest and penalties, outstanding on October 3, 2008 (date of enactment), if attributable to the minimum tax adjustment for ISOs. Second, for taxpayers who have already paid any interest and penalties that would have been abated under this new rule, such interest and penalties can be used—half in 2008 and half in 2009—to increase the “AMT refundable credit amount” and the minimum tax credit.

Another AMT change may benefit energy-conscious taxpayers. Beginning in 2008, the credit for “energy efficient residential property” can be used to offset the AMT.

Retroactive Extensions of Other Individual Provisions

The new law extends through 2009 several provisions that had expired at the end of 2007. These include:

- **State and Local Sales Tax Deduction.** Allows taxpayers to use state and local sales taxes as itemized deductions in lieu of state income taxes
- **Deduction for Qualified Tuition and Related Expenses.** Allows an “above-the-line” deduction (i.e., not part of itemized deductions) for certain higher education expenses. The maximum deduction is \$4,000 or \$2,000, depending on the taxpayer's adjusted gross income (AGI). No deduction is allowed for single filers having AGI above \$80,000 or for joint filers having AGI above \$160,000.
- **Deduction for Classroom Expenses.** Allows an “above-the-line” deduction (i.e., not part of itemized deductions) of up to \$250 for out-of-pocket expenses of teachers and other educators in grades K-12 for items such as books, supplies, and computer equipment used in the classroom.
- **Tax-free IRA Distributions to Charity.** Permits direct distributions to charity of up to \$100,000 from a traditional or Roth IRA maintained for an individual whose has reached age 70½. Ordinarily, such distributions would be taxable to the individual, who would not be able to offset the income fully because of the percentage limitations on charitable contribution deductions.
- **Special Provisions Concerning Mutual Funds.** The new law extends three rules primarily affecting nonresidents who are not U.S. citizens. One concerns “interest-related” dividends from mutual funds. The second is a “look-through” rule for determining the taxability of mutual fund assets for estate tax purposes. The third concerns the treatment of mutual funds for purposes of the Foreign Investment in Real Property Tax Act (“FIRPTA”).

Credit for Residential Energy Efficient Property Extended and Expanded

The new law extends through 2016 the credit for “residential energy efficient property,” which was scheduled to expire at the end of 2008. Also, as noted above, beginning in 2008, taxpayers can use the credit against the alternative minimum tax (“AMT”).

Moreover, the new law retroactively adds two new types of qualifying property, and, beginning after 2008, removes the credit limit for “qualified solar electric property.” Previously, the credit was based on expenditures for three defined types of qualifying property: qualified solar electric property, qualified solar water heating property, and qualified fuel cell property. The new law adds two more categories: qualified small wind energy property and qualified geothermal heat pump property.

The credit for each type of property is 30% of qualifying expenditures, subject to a dollar limit for each. These limits are as follows:

- \$2,000 for qualified solar electric property expenditures in 2008; the limit is removed after 2008.
- \$2,000 for qualified solar water heating property expenditures.
- \$2,000 for qualified geothermal heat pump property expenditures.
- \$500 for each half kilowatt of capacity (not to exceed \$4,000) for qualified small wind energy property expenditures.
- \$500 for each half kilowatt of capacity for qualified fuel cell property expenditures.

Earned Income Threshold for Child Tax Credit Refundability

The new law reduces the earned income threshold for determining the refundability of the child tax credit for 2008 to \$8,500 (from \$12,050).

Real Property Tax Deduction for Nonitemizers

In 2008, individuals who do not itemize their deductions may include, as part of the standard deduction, real property taxes of up to \$500 (\$1,000 for joint filers). The new law extends this rule through 2009.