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Client Update – New Tax Law

Re: 2008 Economic Stimulus Act - General Information

Dear Vertical Advisor Client:

Almost every day, there's another news report about the slowing economy. After years of the strong growth, the economy is slowing in many sectors and in many areas of the country. To help jumpstart the economy, Congress recently passed the Economic Stimulus Act of 2008. It's designed to inject \$152 billion into the U.S economy. More than 100 million Americans will receive rebate checks this year, along with child payments for qualifying children. Businesses can take advantage of two tax breaks: enhanced Code Sec. 179 expensing and bonus depreciation. Finally, Congress also extended some help to the troubled housing sector.

Rebates. Let's take a look at the rebates first. Originally, Congress intended to limit the rebates to individuals and married couples who paid federal taxes in 2007. However, this left out a lot of people. Ultimately, Congress extended the rebates to seniors, disabled veterans and widows of veterans.

The rebates are technically a refundable credit against tax. If you filed a 2007 income tax return, the IRS figures the rebate for you and will send it by mail or direct deposit without your having to take any further action. If you didn't file a 2007 return but still qualify for a rebate because of your earned income level, combat pay, or receipt of Social Security benefits, the IRS has promised to announce how you will get on the rebate list.

The rebates themselves are calculated as the greater of (1) net income tax liability, not to exceed \$600 (\$1,200 for married couples filing jointly), or (2) \$300 (\$600 for joint filers) if the individual has either (a) at least \$3,000 of any combination of earned income, Social Security benefits and certain veterans' benefits (including survivors of disabled veterans), or (b) net income tax liability of at least \$1 and gross income greater than the sum of the applicable basic standard deduction amount and one personal exemption (two if a joint return).

What does this mean? For most single individuals (including heads of households and married filing separately) with adjusted gross income (AGI) of less than \$75,000 and who pay federal income tax, it means they will receive a \$600 rebate. Most married couples filing jointly with adjusted gross income of less than \$150,000 and who pay federal income tax will receive \$1,200. However, the rebates start to phase-out when a single person's income is greater than \$75,000 (\$150,000 for married couples filing jointly). Rebates phase out at five percent of the amount exceeding the applicable AGI threshold. The \$600 credit for individuals therefore phases out completely at \$87,000 AGI, and the \$1,200 credit for married couples filing jointly phases out completely at \$174,000 AGI. Lower income individuals and people living on Social Security or VA benefits will receive minimum rebates of \$300. If you have any questions about how the rebates are calculated, give our office a call and we'll explain it in detail. While the IRS does the math, we advise that you double check the size of the check when it arrives or is deposited.

Filers on extension. Because the rebates are based on your 2007 return, if you file your return after April 15, 2008, your rebate will be delayed. For example, individuals on extension this year who do not file their 2007 return until the extended October 15, 2008 deadline will not receive their checks until year-end. No checks will be sent after December 31, 2008.

After 2008, those who missed out on the rebate or received only a partial rebate get a second shot at qualifying with 2008 data when they file their 2008 return in 2009. This group includes those who did not receive a full \$600/\$1,200 check either because their 2007 income was either too low or too high, or they did not receive a full \$300 child credit

because their income was too high or a child was born or adopted in 2008. They get another chance to claim the difference based on their 2008 tax return filed in 2009. If a taxpayer would have received a smaller rebate check if based on 2008 return information rather than his or her 2007 return, however, the taxpayer is not required to give back the difference.

Although determined based on the 2007 tax year, the rebate technically remains a credit against 2008 tax, payable in the form of an advance payment. Consequently, a taxpayer filing a 2007 return in 2008 cannot claim the rebate as an offset to his or her 2007 tax liability reported on that return in lieu of waiting to receive a check. Neither can the taxpayer choose instead to count the rebate as part of an estimated tax installment for either 2007 or 2008.

Distribution. The Treasury Department and the IRS will issue the rebate checks. The rebates come at a very busy time for the IRS, which is processing tens of millions of 2007 returns and issuing tens of millions of refund checks. However, both the Treasury Department and the IRS have indicated that they can handle the additional work.

Although the Treasury Department and the IRS haven't yet released any specifics, they will likely start to issue the rebate checks in May. The government is also likely to utilize direct deposit as much as possible rather than issuing paper checks. Overall, the government will have to issue or deposit more than 100 million checks, so the rebate process will take some time.

You may remember when the government issued rebate checks seven years ago. The first rebate checks were mailed in July 2001. The entire process took about four months. The rebate checks were mailed to taxpayers based on the last two digits of their Social Security numbers (SSNs). Individuals who's SSNs ended in "00" were the first to receive checks and individuals who's SSNs ended in "99" were the last. The Treasury Department and the IRS are likely to use the same distribution process this year. When we learn how the government intends to issue the checks, we'll let you know. Also, if you owe any federal debts or unpaid child support, the government will apply your rebate to that debt.

Child payments. Besides the rebates, taxpayers with children may be eligible for \$300 payments per child. For purposes of the new law, the child tax credit definition of qualifying child applies. The child credit is allowed with respect to each qualifying child of a taxpayer. A qualifying child must not have attained the age of 17 as of the close of the calendar year in which the taxpayer's tax year begins. The qualifying child must be the taxpayer's qualifying child for purposes of the dependency exemption. Finally, the child must be a son, daughter, stepson, stepdaughter, or descendant of such child, or a brother, sister, stepbrother, stepsister or a descendant of such relative.

Just like the rebates, the child payments phase out for higher income taxpayers. However, there is no cap on the number of child payments that qualifying taxpayers may receive. For example, a married couple with four qualifying children will receive four \$300 payments.

Business incentives. Although not as extensive as originally proposed, the business incentives are nonetheless very valuable with careful planning. The new law nearly doubles the amount of deductible Code Sec. 179 expensing for 2008 and also provides for bonus depreciation. The new law does not allow taxpayers to carry back net operating losses beyond the current limits. Many businesses lobbied hard for this treatment but Congress left it out. However, there is talk on Capitol Hill of a second stimulus bill, so there may be more business tax incentives later this year.

Small business expensing. Before the new law, a business could expense up to \$128,000 of the cost of qualifying property in 2008. If the cost of qualified property placed in service during the year is more than \$510,000, the ceiling for that business is reduced by the amount over the applicable limit. Under the new law, a business can expense up to \$250,000 of the cost of qualifying property and the old \$510,000 ceiling jumps to \$800,000. These are some very generous changes. If you're thinking about making a purchase for your business, give us a call. We can help you maximize your tax savings under the new law.

The new law makes no changes to the general rules for the types of property that are eligible for expensing. Generally, the property must be tangible personal property, which is actively used in the taxpayer's business and for which a

depreciation deduction would be allowed. The property must be used more than 50 percent for business and must be newly purchased property. The existing exception for computer software applies to the enhanced expensing amounts under the new law.

Bonus depreciation. The other incentive is bonus depreciation. The new law provides qualifying taxpayers 50 percent first-year bonus depreciation of the adjusted basis of qualifying property. This provision is substantial, providing American businesses with an estimate \$44 billion in additional deductions in 2008. Even compared against the rebate checks \$107 billion price tag, the new bonus depreciation is huge.

To be eligible to claim bonus depreciation, property must be (1) eligible for the modified accelerated cost recovery system (MACRS) with a depreciation period of 20 years or less; (2) water utility property; (3) computer software (off-the-shelf); or (4) qualified leasehold property. The property generally must be purchased and placed in service during 2008. Original use of the property must begin with the taxpayer and must occur after December 31, 2007 and before January 1, 2009. There are exceptions for certain transportation property.

Congress also increased the Code Sec. 280F limitations on "luxury" auto depreciation to accommodate a modified version of the 50-bonus depreciation available to other "MACRS" property. Ordinarily, the first-year limit on depreciation for passenger automobiles cannot exceed \$3,060. However, this limit was increased when bonus depreciation was previously available to \$4,600. The new law raises the cap once again, this time by \$8,000 if bonus depreciation is claimed for a qualifying vehicle. Thus, for passenger autos, the cap on 50 percent bonus depreciation is set at \$11,060; for trucks and vans, \$11,260.

Foreclosure help. The fallout from the subprime mortgage crisis continues to unfold in America's financial and housing markets. In many areas, foreclosure rates have hit all-time highs.

The new law raises the maximum amounts of principal for mortgages issued by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). These large mortgages are often called "jumbo mortgages." The government hopes that by backing these larger mortgages, lenders will lower interest rates.

Based on my discussions with mortgage lenders and real estate specialists, I understand that FHA is waiting to receive the median house price census by county for the whole United States. This is supposed to be issued on March 1, 2008. After FHA has the median home price, they will increase the conforming loan rates by 125% of the median home price in each county. Apparently, Fannie Mae and Freddie Mac will follow FHA, but it is expected they will act slower.

We are expecting that these loans, although larger in size will require better credit, and income than the previous subprime market requirements. It will be interesting to see how it all pans out.

As always, if you have any questions about the new law, don't hesitate to contact us. We are ready to help you maximize your tax savings.

Sincerely yours,
VERTICAL ADVISORS, LLP



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