



PIASCİK & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

Main / 804-527-1815

Toll Free / 866-527-1815

Fax / 804-527-1816

Innsbrook Corporate Center

4470 Cox Road, Suite 250

Glen Allen, Virginia 23060

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Mr. A Smith

Dear Mr. Smith:

HOW INDIVIDUALS ARE AFFECTED BY TAX CHANGES IN THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008

As I'm sure you're aware, on Oct. 3, 2008, the President signed into law the Emergency Economic Stabilization Act of 2008 (P.L. 110-343). Although virtually all of the press coverage of this law has concentrated on its hotly debated \$700 billion financial industry bailout plan, the legislation also contains scores of tax changes, mostly beneficial, for individuals and businesses alike.

Here's a brief review of the tax provisions individuals need to know about right now.

AMT relief: In general terms, to find out if you owe alternative minimum tax (AMT), you start with regular taxable income, modify it with various adjustments and preferences (such as addbacks for property and income tax deductions and dependency exemptions), and then subtract an exemption amount (which phases out at higher levels of income). The result is multiplied by an AMT tax rate of 26% or 28% to arrive at the tentative minimum tax. You pay the AMT only if the tentative minimum tax exceeds your regular tax bill. Although it was originally enacted to make sure that wealthy individuals did not escape paying taxes, the AMT has wound up ensnaring many middle-income taxpayers. One reason is that many of the tax figures (such as the tax brackets, standard deductions, and personal exemptions) used to arrive at your regular tax bill are adjusted for inflation, but the tax figures used to arrive at the AMT are not.

For 2008 only, the new law provides some relief. It increases the maximum AMT exemption amount over its 2007 level by \$3,700 for married taxpayers filing joint returns, and by \$1,850 for unmarried individuals and married persons filing separately. However, after 2008 the maximum AMT exemption amount will drop precipitously to where it was in the year 2000 unless Congress provides yet another fix.

Another provision in the new law provides AMT relief for those individuals claiming certain "nonrefundable" personal tax credits (such as the credit for dependent care and the Scholarship and Lifetime Learning credits). For 2008, these credits may offset an individual's regular tax and AMT. After 2008, unless Congress acts, these credits will be allowed only to the extent that an individual has regular income tax liability in excess of the tentative minimum tax.

The new law also liberalized the AMT refundable credit amount that was first enacted in 2006 to help taxpayers who were stung by the AMT as a result of exercising incentive stock options (ISOs). The changes are highly technical but their essence is that for tax years beginning after 2007: (1) eligible individuals may claim this credit more rapidly (i.e., over fewer years) than would have been the case without the change; and (2) the AMT refundable credit amount no longer phases out at higher levels of adjusted gross income (AGI). In addition, the new law wipes out any tax underpayments (plus interest & penalties) outstanding on Oct. 3, 2008, that are attributable to pre-2008 phantom ISO income under the AMT rules.

Retroactively resuscitated and extended tax breaks: All of the following tax breaks had expired at the end of last year. The new law retroactively resuscitates them so that they apply for 2008, and also extends them for one year so that they will apply for 2009 as well:

- ... The option to claim an itemized deduction for state and local general sales taxes instead of the itemized deduction for state and local income taxes.
- ... The above-the-line deduction for qualified tuition and related expenses for higher education paid during the tax year.
- ... The up-to-\$250 eligible educator's above-the-line deduction for books, supplies, computer equipment, etc., used by him or her in the classroom.
- ... The up-to-\$100,000 annual exclusion from gross income for taxpayers age 70 1/2 or older who make direct transfers of otherwise taxable individual retirement account (IRA) distributions to qualified charitable organizations.

The new law also extends for one year the nonitemizers' additional standard deduction for State and local property taxes paid. The deduction can't exceed the lesser of state and local property taxes actually paid or \$500 (\$1,000 for joint return filers). This deduction was supposed to have been available only for 2008, but the new law makes it available for 2009 as well.

Deductions for energy saving home improvements extended and expanded: Two tax credits are available for taxpayers who make energy saving improvements to residences. They've both been extended by the new law and expanded as well:

(1) A generous tax credit is available to individuals who add solar energy equipment or fuel-cell equipment (new technology that converts fuel into electricity using electromechanical methods, and meets other detailed requirements) to their residences. The new law extends this credit through 2016. It also liberalizes the credit in an important way: For 2008, you can claim a tax credit of 30% of the cost of equipment that uses solar energy to generate electricity (photovoltaic property), up to a \$2,000 maximum tax credit. After 2008, there's no dollar limitation on the credit. For example, suppose you spend \$8,000 buying and installing solar heating panels on your residence. If you make the improvement this year, you may claim a maximum credit of \$2,000, but if you make the improvement next year, you may claim a credit of \$2,400 (30% of \$8,000).

Additionally, starting with 2008, the new law makes the credit available for more-exotic energy generating/retaining equipment: wind turbines; and geothermal heat pumps.

(2) For equipment installed before 2008, you could claim a credit for the cost of buying an assortment of energy saving improvements and installing them in your main home. The credit depends on the type of improvement (e.g., 10% of the cost of energy efficient building envelope components, such as insulation and windows, and an up to \$150 credit for a natural gas, propane, or oil furnace or hot water boiler) and there's an overall \$500 lifetime dollar limit for all improvements.

The new law does *not* extend this credit for qualifying equipment bought and installed in 2008, but it *does* make it available once again for qualifying equipment bought and installed in 2009. Also, for 2009, the new law makes the credit available for certain types of energy efficient biomass fuel stoves and certain types of energy saving asphalt roofs.

New tax relief for victims of Presidentially declared disasters: Individuals may deduct personal casualty losses (e.g., unreimbursed damage to a car due to a storm) or personal theft losses only if they exceed a \$100 limit per casualty or theft and only to the extent these losses in the aggregate exceed 10% of adjusted gross income (AGI). If the disaster occurs in a Presidentially declared disaster area, an individual may elect to take into account the casualty loss in the year immediately preceding the year in which the disaster occurs. Before 2008, only itemizers could deduct casualty losses.

The new law waives the 10% -of-AGI limit for victims of disasters declared to be federal disasters in 2008 and 2009, plus, for these years, permits nonitemizers to claim a deduction for federal disaster losses. However, for 2009 only, the new law boosts the \$100 per casualty limit to \$500 (which will have the effect of reducing deductions).

The new law also gives a number of extra tax breaks to victims of the storms and hurricanes that pummeled ten Midwest states during 2008.

More detailed reporting of securities transactions – after 2010: Stock brokers must file an information return (Form 1099-B) for securities transactions they handle. Currently, brokers report the name and address of the customer, when the sale took place, what was sold, and the gross proceeds of the sale. Starting with stocks (as well as bonds and several other financial instruments) bought after 2010 (a later date applies to some specialized securities), brokers will have to report the customer's adjusted basis (essentially cost for tax purposes) and whether a gain or loss on the transaction was short- or long-term. This new information reporting requirement is designed to boost IRS's compliance efforts (e.g., help assure taxpayers properly report their gains and losses).

Please keep in mind that I've described only the highlights of how the new law affects you. If you would like more details, please call me at your convenience.

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Ryan L. Losi, CPA
Executive Vice President