Chapter 11: New Legislation

Corrections were made to this workbook through January of 2009. No subsequent modifications were made.

This chapter covers tax legislation enacted in 2008 and reviews provisions enacted in 2007 or earlier that are effective for 2008.

PROVISIONS FOR 2008 FROM PRIOR ACTS

These are provisions of prior tax acts that first become effective in 2008.

NET CAPITAL GAIN AND QUALIFIED DIVIDEND TAX RATE

For the years 2008 through 2010, the tax rate for capital gains for those taxpayers in the 15% or lower tax brackets is 0%. The rate applies for both regular and alternative minimum tax.

Note. This provision is discussed in detail in Chapter 9, "Individual Taxpayer Problems."

IRA CONTRIBUTION LIMIT

The contribution limits for both traditional and Roth IRAs increased to the lesser of $5,000 or taxable income. Taxpayers age 50 and over qualify for an additional $1,000 annual contribution.

The contribution limit to a traditional IRA is reduced in 2008 for taxpayers active in an employer-sponsored plan and whose modified AGI (MAGI) exceeds $85,000 (for married filing jointly). A taxpayer is not considered an active participant just because the spouse is an active participant. A spouse who is married to an active participant but is not an active participant himself is subject to a different phaseout range. This phaseout range begins at $159,000. The phaseout for an unmarried individual or a head-of-household filer begins at $53,000. For those who file married filing separately, the phaseout begins at $0.

The contribution limit to a Roth IRA is reduced in 2008 if MAGI exceeds $159,000 for those who file married filing jointly and qualifying widow(er)s, and $101,000 for all other taxpayers except those filing married filing separately. Married filing separately taxpayers are ineligible for a Roth IRA contribution if their MAGI is over $10,000.

> **Note.** See Chapter 12, "Retirement," for more information on IRA contributions and MAGI limitations.

ROLLOVERS TO ROTH IRAS

Beginning in 2008, taxpayers can make rollovers to a Roth IRA from the following retirement plans:

- Traditional IRA
- SEP
- SIMPLE IRA
- Qualified pension, profit sharing, or stock-bonus plans
- §401(k) plans
- Annuity plans
- §403(b) plans
- §457 plans

The rules are the same as those used for rollovers from a traditional IRA to a Roth IRA. This includes an AGI limitation and a filing-status limitation. These restrictions are removed for rollovers after December 31, 2009.

> **Note.** See Chapter 12, "Retirement," for more information on rollovers to Roth IRAs.

PHASEOUT OF REDUCTIONS

High-income taxpayers lose a portion of the benefit of personal exemptions and itemized deductions if their AGI exceeds a threshold amount. For 2008, the threshold beginning amounts are shown below.

Filing Status	AGI
Married filing jointly or widow(er)	$239,950
Head of household	199,950
Single	159,950
Married filing separately	119,975

A provision in the Economic Growth and Tax Relief Reconciliation Act of 2001 provided for a phaseout in the reduction of the personal exemption and itemized deduction amounts for these taxpayers. For tax years beginning in 2006 and 2007, the reduction was one-third of the phaseout amount. **In 2008 and 2009, the reduction is two-thirds of the phaseout amount.** In 2010, there is no phaseout limitation, but the law sunsets for years beginning after 2010 when there will be no reduction in the phaseout amount.

KIDDIE TAX

The age of dependents subject to the kiddie tax increases for tax years beginning after May 25, 2007. The Small Business and Work Opportunity Tax Act of 2007 extends the tax to taxpayers, age 18; and full-time students between the ages of 19 and 23 if they do not provide more than half of their support with earned income.

Note. A detailed discussion of the kiddie tax is provided in Chapter 9, "Individual Taxpayer Problems."

TAX LEGISLATION PASSED IN DECEMBER 2007

The following tax legislation was passed by Congress and signed by President Bush in December 2007:

- Tax Increase Prevention Act of 2007 (signed December 26, 2007)
- Mortgage Forgiveness Debt Relief Act of 2007 (signed December 20, 2007)
- Energy Independence and Security Act of 2007 (signed December 19, 2007)
- Virginia Tech Victims Tax Relief (signed December 19, 2007)
- Technical Corrections Act of 2007 (signed December 29, 2007)

The most important tax provisions contained in these five bills are analyzed below. In addition, some provisions that applied in 2007 were not extended to 2008.

TAX INCREASE PREVENTION ACT OF 2007

Higher AMT Exemption Amounts for 2007

The AMT "patch" prevented many taxpayers from owing AMT on their 2007 individual tax returns. The 2007 AMT exemption amounts are shown below.

Filing Status	Exemption Amount
Married filing jointly or qualifying widow(er)	$66,250
Single or head of household	44,350
Married filing separately	33,125

The late passage of the AMT extension prevented many taxpayers from receiving an early refund because the IRS had to update their computer software to reflect the increased exemption amounts.

Note. Unfortunately, the extension of the AMT exemption amount was only effective for 2007. As of the date this book was printed, no 2008 AMT legislation has been enacted. However, an extension and/or increase in the exemption amount is expected. Without an extension, the 2008 AMT exemption for MFJ returns is $45,000.

Nonrefundable Personal Credits

The Act extended the allowance of most nonrefundable personal credits against both regular tax and AMT liability. These credits are listed in Chapter 9, "Individual Taxpayer Problems," Problem 1. However, this favorable rule does not apply to the personal-use portion of the tax credit for new qualified hybrid vehicles claimed on Form 8910, *Alternative Motor Vehicle Credit*. Therefore, taxpayers who purchased new hybrid vehicles could be denied part or all of their otherwise allowable hybrid vehicle credit if they had a tentative minimum tax liability on their Form 6251, *Alternative Minimum Tax — Individuals.*

> **Note.** A detailed discussion of AMT is found in Chapter 9, "Individual Taxpayer Problems."

MORTGAGE FORGIVENESS DEBT RELIEF ACT OF 2007

Exclusion of Debt Forgiveness on Principal-Residence Mortgages

> **Note.** A detailed discussion of debt forgiveness on principal-residence mortgages is included in Chapter 13, "Financial Distress."

Exclusion of State and Local Tax Benefits and Pay for Volunteer Firefighters and Emergency Responders

Some states and localities exempt volunteer firefighters and emergency service providers from real estate, personal property, and income taxes. The Mortgage Forgiveness Debt Relief Act of 2007 contains a provision allowing these state and local benefits an exclusion from federal tax.

For tax years 2008 through 2010, these types of remuneration for volunteer services are excluded from gross income. However, there was no provision to exclude these qualified payments from the definition of wages. Consequently, tax withholding is still required. The qualified-payments exclusion is limited to $30 per month multiplied by the number of months in the year the volunteer provided these services.

> **Note.** The HEART Act of 2008 (explained later in this chapter) excludes these state- and locally-provided benefits from wages. Section 115(d) of the HEART Act is effective for tax years beginning after December 31, 2007.

Extended Time Period for Surviving Spouses to Sell Principal Residence

Old Law. Generally, a surviving spouse who sold a home which was jointly owned and occupied by both spouses could claim the $500,000 gain exclusion only if the sale occurred in the tax year of death. If the surviving spouse sold the principal residence in a tax year after death, the unmarried surviving spouse was considered a single taxpayer and only entitled to the maximum $250,000 exclusion on the gain.

New Law. Beginning on January 1, 2008, an unmarried surviving spouse is entitled to the $500,000 exclusion that applies to joint return filers if the sale of the principal residence occurs within two years of the date of death.

Example 1. Seth and Mary bought their jointly-owned principal residence in 1960. Seth died on July 8, 2008. Mary, who does not remarry, sells the residence on July 7, 2010, and realizes a gain in excess of $500,000. She may exclude the first $500,000 of gain on her 2010 single filing status Form 1040.

> **Note.** Mary is entitled to a step-up in basis for Seth's half of the home, which she inherited on his death in 2008. This assumes Seth owned half of the home at the time of his death.

Mortgage Insurance Premium Deduction Extended

Old Law. Taxpayers were entitled to deduct premiums paid on qualified mortgage insurance on principal or second residences if the insurance was issued during 2007. The deduction did not apply to any mortgage insurance contracts issued before January 1, 2007. The deduction was subject to a phaseout based on the taxpayer's 2007 AGI. The phaseout began when 2007 AGI exceeded $100,000 for all but married taxpayers who filed separately. For married taxpayers filing separately, the phaseout began when 2007 AGI exceeded $50,000. This deduction was originally only available for the 2007 tax year and was deducted on Schedule A, line 13 as deemed home mortgage interest.

New Law. This deduction is extended for tax years 2008 through 2010 for mortgage insurance contracts issued between January 1, 2007, and December 31, 2010.

Higher Penalties for Partnership Returns

Old Law. Under IRC §6698, a partnership that failed to timely file a partnership return could be penalized $50 per partner for a maximum of five months. This penalty is assessed against the partnership. This penalty is waived if the failure to file is due to a reasonable cause.

New Law. In 2008, the penalty per partner per month increased from $50 to $85. The maximum period for assessing the penalty increased from five months to 12 months. The maximum for a two-partner partnership increased from $500 to $2,040. The increased penalty applies to partnership returns required to be filed on or after December 21, 2007. The reasonable-cause exception is retained and certain small partnerships can be excepted. The exception is detailed in Rev. Proc. 84-35.[1]

New Penalties for S Corporations

Old Law. Under IRC §7203, S corporations could be penalized for failure to timely file a Form 1120S and timely provide each shareholder with a Schedule K-1, but only if the failure was willful.

New Law. The new failure-to-file penalty for S corporations is similar to the partnership failure-to-file penalty. For any failure to file required information returns, S corporations can be assessed a penalty equal to $85 per shareholder for a maximum of 12 months. The new penalty applies to 1120S returns required to be filed on or after December 21, 2007. This penalty is waived if the failure to file is due to a reasonable cause.

ENERGY INDEPENDENCE AND SECURITY ACT OF 2007

Temporary FUTA Surtax Extended

The 0.2% temporary FUTA surtax is extended for 2008. This surtax, which became effective in 1977, has been consistently extended each year since 1977. As a result, the total FUTA tax rate for 2008 is 6.2% on the first $7,000 in wages paid to an employee. However, a credit for state unemployment taxes paid may be claimed.

VIRGINIA TECH VICTIMS TAX RELIEF

Any payments to shooting victims received from the Virginia Tech Memorial Fund are excluded from gross income.

TECHNICAL CORRECTIONS ACT OF 2007

The Technical Corrections Act of 2007 (TCA) made several revisions to, and clarifications of, existing tax legislation. The provision affecting most taxpayers deals with the AMT credit.

> **Note.** The Act clarified the computation of the AMT credit. This is discussed in detail in Chapter 9, "Individual Taxpayer Problems."

1. Rev. Proc. 84-35, 1984-1 CB 509

ECONOMIC STIMULUS ACT OF 2008

ADVANCE CREDIT PAYMENTS

President Bush signed the Economic Stimulus Act of 2008 (ESA) on February 13, 2008. The Act provides advance tax credits for most Americans and depreciation incentives for small businesses. It is estimated that 130 million Americans are eligible for tax rebates of up to $600 for individuals and $1,200 for married couples. An additional $300 is paid for each qualifying child (as defined for purposes of the child tax credit). While the rebate checks were sent out beginning in May 2008, they are actually a credit which will be claimed on the 2008 tax return. Taxpayers will need to enter the amount of the rebate received in order for the IRS to make any corrections if the taxpayer is entitled to a larger rebate. Taxpayers must have filed a 2007 tax return no later than October 15 to have received a rebate. No rebate checks will be issued after December 31, 2008.

The rebate is phased out for high-income taxpayers. The phaseout is 5% of AGI over the income limitation. For singles, the limit is $75,000 and for married couples, the amount is $150,000.

The advance payment is based on 2007 income; however, the rebate can be adjusted upward based on 2008 income. If the 2008 income is higher and results in a smaller rebate, the excess rebate does not have to be repaid.

> **Example 2.** Amedeus and Desdemona are married with no children. Their 2007 AGI is $160,000. They are only entitled to a rebate of $700 ($1,200 – (($160,000 – $150,000) × 5%).

> **Example 3.** Amedeus and Desdemona from **Example 2** have a child in 2008. Their 2008 AGI is $140,000. Because this is below the $150,000 limitation, they are entitled to an additional 2008 credit of $500, plus $300 for the child ($1,200 + $300 – $700).

The theory behind the rebate amount is that it gives back the amount of tax paid in the 10% bracket on up to $6,000 for singles and $12,000 for married couples.

> **Example 4.** Heath files his return using the single status. In 2007, he had $5,000 of taxable income. Therefore, he will receive a rebate check of $500 ($5,000 × 10%).

Individuals who do not normally file a tax return are entitled to a rebate of $300 if they have at least $3,000 of earned income, social security and/or disability income. These are taxpayers who would normally not be required to file. However, they must file a 2007 return to qualify for the rebate. The IRS released a copy of Form 1040A and marked the lines which must be completed.

Write the words "Stimulus Payment" across the top of the form you file.

Form **1040A** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return 2007
IRS Use Only—Do not write or staple in this space.
OMB No. 1545-0074

EXAMPLE ONLY DO NOT FILE

Label (See page 15.)
LABEL HERE
Use the IRS label. Otherwise, please print or type.

Your first name and initial: Rufus	Last name: Maple		Your social security number: 011 : 00 : 2222
If a joint return, spouse's first name and initial: Mary	Last name: Maple		Spouse's social security number: 011 : 00 : 1111
Home address (number and street). If you have a P.O. box, see page 15. 1234 Main Street		Apt. no.	▲ You **must** enter your SSN(s) above. ▲
City, town or post office, state, and ZIP code. If you have a foreign address, see page 15. Anytown, LA 70000			Checking a box below will not change your tax or refund.

Presidential Election Campaign ▶ Check here if you, or your spouse if filing jointly, want $3 to go to this fund (see page 15) ▶ ☐ You ☐ Spouse

Filing status
Check only one box.

1 ☐ Single
2 ☐ Married filing jointly (even if only one had income)
3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See page 16.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child (see page 17)

Exemptions

6a ☐ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a.
b ☐ **Spouse**
c **Dependents:**

If more than six dependents, see page 18.

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if qualifying child for child tax credit (see page 18)
			☐
			☐
			☐
			☐
			☐

Boxes checked on 6a and 6b
No. of children on 6c who:
• lived with you
• did not live with you due to divorce or separation (see page 19)
Dependents on 6c not entered above
Add numbers on lines above ▶

If you were self-employed or a partner, include the amount you would enter on Schedule SE, line 4 only if it is less than $400.

d Total number of exemptions claimed.

Income

Attach Form(s) W-2 here. Also attach Form(s) 1099-R if tax was withheld.

If you did not get a W-2, see page 21.

Enclose, but do not attach, any payment.

Social security, tier 1 railroad retirement, and veterans compensation, disability and death benefits

7 Wages, salaries, tips, etc. Attach Form(s) W-2. 7
8a **Taxable** interest. Attach Schedule 1 if required. 8a
b **Tax-exempt** interest. **Do not** include on line 8a. 8b
9a Ordinary dividends. Attach Schedule 1 if required. 9a
b Qualified dividends (see page 22). 9b
10 Capital gain distributions (see page 22). 10
11a IRA distributions. 11a — 11b Taxable amount (see page 22). 11b
12a Pensions and annuities. 12a — 12b Taxable amount (see page 23). 12b
13 Unemployment compensation and Alaska Permanent Fund dividends. 13
14a Social security benefits. 14a — 14b Taxable amount (see page 25). 14b
15 Add lines 7 through 14b (far right column). This is your **total income.** ▶ 15

Adjusted gross income

16 Educator expenses (see page 25). 16
17 IRA deduction (see page 27). 17
18 Student loan interest deduction (see page 29). 18
19 Tuition and fees deduction. Attach Form 8917. 19
20 Add lines 16 through 19. These are your **total adjustments.** 20
21 Subtract line 20 from line 15. This is your **adjusted gross income.** ▶ 21

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 74. Cat. No. 11327A Form **1040A** (2007)

11

Form 1040A (2007) Page **2**

Tax, credits, and payments

22	Enter the amount from line 21 (adjusted gross income).		22	
23a	Check if: ☐ **You** were born before January 2, 1943, ☐ Blind; ☐ **Spouse** was born before January 2, 1943, ☐ Blind. **Total boxes checked** ▶	23a ☐		
b	If you are married filing separately and your spouse itemizes deductions, see page 30 and check here ▶	23b ☐		
24	Enter your **standard deduction** (see left margin).		24	
25	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.		25	
26	If line 22 is $117,300 or less, multiply $3,400 by the total number of exemptions claimed on line 6d. If line 22 is over $117,300, see the worksheet on page 32.		26	
27	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your **taxable income.** ▶		27	
28	**Tax,** including any alternative minimum tax (see page 30).		28	
29	Credit for child and dependent care expenses. Attach Schedule 2.	29		
30	Credit for the elderly or the disabled. Attach Schedule 3.	30		
31	Education credits. Attach Form 8863.	31		
32	Child tax credit (see page 35). Attach Form 8901 if required.	32		
33	Retirement savings contributions credit. Attach Form 8880.	33		
34	Add lines 29 through 33. These are your **total credits.**		34	
35	Subtract line 34 from line 28. If line 34 is more than line 28, enter -0-.		35	
36	Advance earned income credit payments from Form(s) W-2, box 9.		36	
37	Add lines 35 and 36. This is your **total tax.** ▶		37	
38	Federal income tax withheld from Forms W-2 and 1099.	38		
39	2007 estimated tax payments and amount applied from 2006 return.	39		
40a	**Earned income credit (EIC).**	40a		
b	Nontaxable combat pay election. 40b			
41	Additional child tax credit. Attach Form 8812.	41		
42	Add lines 38, 39, 40a, and 41. These are your **total payments.** ▶		42	

Standard Deduction for—

- People who checked any box on line 23a or 23b **or** who can be claimed as a dependent, see page 30.
- All others:

Single or Married filing separately, $5,350

Married filing jointly or Qualifying widow(er), $10,700

Head of household, $7,850

If you have a qualifying child, attach Schedule EIC.

EXAMPLE ONLY DO NOT FILE

Refund

43	If line 42 is more than line 37, subtract line 37 from line 42. This is the amount you **overpaid.**		43	
44a	Amount of line 43 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐		44a	
▶ b	Routing number ▶ c Type: ☐ Checking ☐ Savings			
▶ d	Account number			
45	Amount of line 43 you want **applied to your 2008 estimated tax.**	45		

Direct deposit? See page 52 and fill in 44b, 44c, and 44d or Form 8888.

Amount you owe

46	**Amount you owe.** Subtract line 42 from line 37. For details on how to pay, see page 53. ▶		46	
47	Estimated tax penalty (see page 53).	47		

Third party designee

Do you want to allow another person to discuss this return with the IRS (see page 54)? ☐ **Yes.** Complete the following. ☐ **No**

Designee's name ▶ Phone no. ▶ ( ) Personal identification number (PIN) ▶

Sign here

Joint return? See page 15. Keep a copy for your records.

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

Your signature	Date	Your occupation	Daytime phone number ( )
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	

Paid preparer's use only

Preparer's signature ▶	Date	Check if self-employed ☐	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code ▶		EIN	Phone no. ( )

Form **1040A** (2007)

Military personnel serving in combat zones have the option of including their nontaxable combat pay on their 2007 tax return if it increases their eligibility for an economic-stimulus payment. To receive the payment in 2008, they must file their 2007 return by October 15, 2008. Otherwise, the payment will appear on their 2008 return. The filing deadline for those serving in a combat zone is normally extended until 180 days after leaving the combat zone. However, spouses or others with a power of attorney can prepare and file the 2007 tax return on the military person's behalf so the payment is received in 2008.

Note. The payments to taxpayers having unpaid federal obligations such as unpaid child support, back taxes, and federal student loans will be offset against these obligations. However, the payment will not prevent eligibility for any federally-funded relief program.

The following taxpayers do not qualify for a rebate:

- Taxpayers who do not file a 2007 return
- Taxpayers with a 2007 net income tax liability of zero and whose qualifying income (wages, net SE income, nontaxable combat pay, social security benefits, certain railroad retirement benefits, and certain veterans' payments) is less than $3,000
- Persons who can be claimed as a dependent on someone else's return
- Persons not having a valid social security number
- Nonresident aliens
- Taxpayers who file a Form 1040NR, Form 1040NR-EZ, Form 1040PR or Form 1040SS
- Estates
- Trusts

BUSINESS INCENTIVES

Enhanced Expense Deduction

The ESA increases the §179 expensing election for 2008 purchases. The maximum deduction is increased to $250,000 and the phaseout threshold is increased to $800,000. This is an increase from $128,000 and $510,000, respectively. The newly acquired expense amount is not adjusted for inflation as was the old deduction. The phaseout is dollar-for-dollar, and the deduction is completely phased out at $1,050,000. The ESA does not increase the expense deduction on sport utility vehicles, which remains at $25,000.

There is no change in the rules for property qualifying for the expensing election. The property must be tangible personal property used in an active trade or business and eligible for depreciation. The purchase must be for new property, and the property must be used more than 50% in the business. The recapture rules continue to apply.

For fiscal-year filers, the purchases must be made in the tax year beginning in 2008 to be eligible for the enhanced expensing election.

Bonus Depreciation

The ESA reinstates 50% bonus depreciation. To qualify for the additional depreciation, the property must:

- Have original use commence with the taxpayer (new),
- Be purchased and placed into service in 2008,
- Be eligible for MACRS depreciation, and
- Have a depreciation period of 20 years or less.

The property does not qualify if it was subject to a binding, written contract prior to January 1, 2008. Property with a recovery period of 10 or more years **and** certain transportation property have an extended placed-in-service date of one year. To be eligible for the extended placed-in-service date, the property must also be subject to IRC §263A and have a cost exceeding $1 million.

Eligible property also includes:

- Water utility property,
- Off-the-shelf computer software, and
- Qualified leasehold improvement property.

Caution. Unlike the §179 deduction, the 50% bonus depreciation is only available for purchases of new property made between January 1 and December 31, 2008. This applies to both calendar- and fiscal-year filers.

Luxury Auto Limit

Prior to the ESA, the 2008 depreciation ceiling on luxury automobiles was $2,960 for passenger vehicles and $3,160 for vans and trucks. The ESA increased this ceiling amount to $10,960 for passenger vehicles and $11,160 for vans and trucks if the 50% bonus depreciation is claimed. If the vehicle ceases to be used 50% for business in a later year, the bonus depreciation is recaptured.

Note. Details of both the increased expensing deduction and the 50% bonus depreciation can be found in Chapter 7, "Depreciation."

FOOD, CONSERVATION, AND ENERGY ACT OF 2008

The Food, Conservation, and Energy Act of 2008 (2008 Farm Bill, or FCEA) has a unique and complex history. H.R. 2419, the Food and Energy Security Act of 2007, better known as the 2007 Farm Bill, was passed by the House on May 14, 2008, the Senate on May 15, 2008, and vetoed by the president on May 21, 2008. On May 21 and 22, Congress overrode the president's veto. Due to a procedural error, the validity of both votes was in question. Unfortunately, the document which went to the president did not contain the entire bill. The bill failed to include 34 pages of nontax trade provisions. These provisions were also omitted from the bill which came back to Congress for the veto override. On May 22 and June 5, 2008, the House of Representatives and the Senate, respectively, passed H.R. 6124. It repealed H.R. 2419, but contained the entire contents of H.R. 2419, including the previously-omitted section. This bill was also vetoed by the president, but the veto was overridden by Congress on June 18, 2008. Congress worded the law such that the provisions are effective on the earlier of the date of enactment of the original bill or the subsequent bill. While the legislation is comprehensive and deals with numerous nontax provisions, there are several key tax provisions contained in the bill. The following is a summary of the key tax provisions contained in the 2008 Farm Bill.

Note. There is uncertainty as to the effective date of the Farm Bill tax provisions. Because H.R. 2419, as vetoed by the president, was not identical to the version Congress passed, there is a constitutional question as to whether H.R. 2419 ever became effective. If H.R. 2419 was not constitutionally enacted, the Farm Bill tax provisions (H.R. 6124) that took effect upon enactment are effective June 18, 2008, rather than May 22, 2008. Because this has not been clarified before the printing of this book, May 22, 2008, is used as the enactment date in this section of the chapter.

CONSERVATION-RELATED PROVISIONS

Certain CRP Payments Excluded from SECA

Conservation reserve program (CRP) payments received by individuals are excluded from SECA if the recipient is receiving social security retirement or disability payments. The payments are treated as rentals from real estate. Consequently, the payments do not reduce social security retirement or disability benefits because they are excluded from earned income. This provision is effective for payments made after December 31, 2007.[2]

Note. Recipients of CRP payments who do not receive social security retirement or disability payments continue to be liable for the SECA tax even if they do not participate in the farming operation. IRS Notice 2006-108 remains in effect for those recipients. Accordingly, for both active and retired farmers, CRP payments continue to be reported on Schedule F as agricultural program payments. For farmers receiving social security retirement or disability benefits, the amount not subject to SECA is then reported on Form 1040, Schedule SE, line 1b in Section A or line 1b of Section B which excludes the payment from SE tax.

2. Section 15301 of the FCEA, amending IRC §1402(a)

2008 Workbook

SCHEDULE SE (Form 1040)
Department of the Treasury
Internal Revenue Service (99)

Self-Employment Tax

▶ Attach to Form 1040. ▶ See Instructions for Schedule SE (Form 1040).

OMB No. 1545-0074
2008
Attachment Sequence No. 17

Name of person with **self-employment** income (as shown on Form 1040)	Social security number of person with **self-employment** income ▶

Who Must File Schedule SE

You must file Schedule SE if:

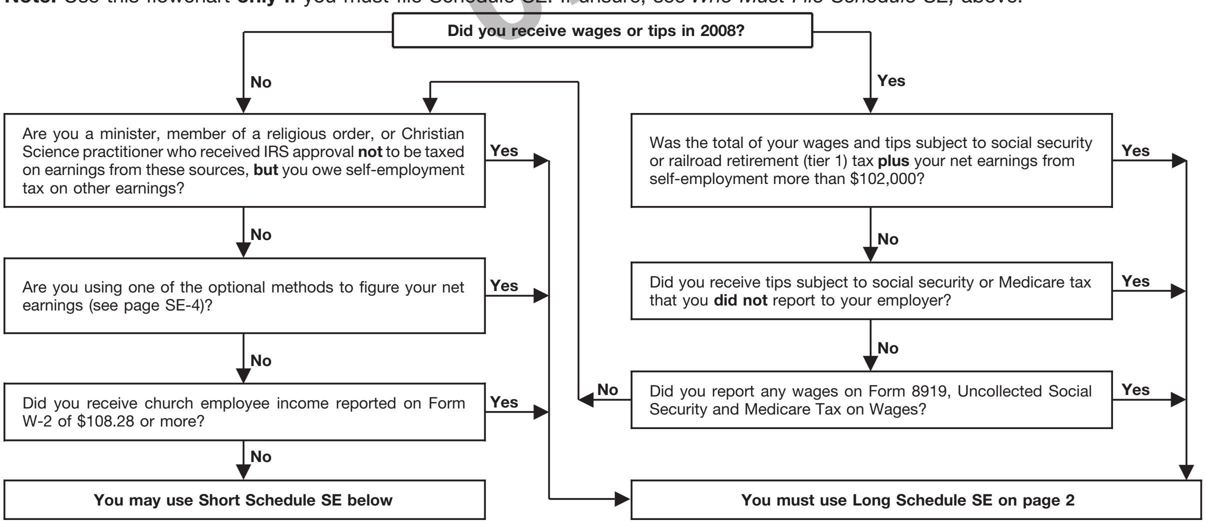
- You had net earnings from self-employment from **other than** church employee income (line 4 of Short Schedule SE or line 4c of Long Schedule SE) of $400 or more, **or**
- You had church employee income of $108.28 or more. Income from services you performed as a minister or a member of a religious order **is not** church employee income (see page SE-1).

Note. Even if you had a loss or a small amount of income from self-employment, it may be to your benefit to file Schedule SE and use either "optional method" in Part II of Long Schedule SE (see page SE-4).

Exception. If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361 and received IRS approval not to be taxed on those earnings, **do not** file Schedule SE. Instead, write "Exempt—Form 4361" on Form 1040, line 57.

May I Use Short Schedule SE or Must I Use Long Schedule SE?

Note. Use this flowchart **only if** you must file Schedule SE. If unsure, see *Who Must File Schedule SE,* above.



Section A—Short Schedule SE. Caution. Read above to see if you can use Short Schedule SE.

1a	Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A	1a	
b	If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 6b, or listed on Schedule K-1 (Form 1065), box 20, code X	1b	( )
2	Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see page SE-1 for types of income to report on this line. See page SE-3 for other income to report	2	
3	Combine lines 1a, 1b, and 2	3	
4	**Net earnings from self-employment.** Multiply line 3 by 92.35% (.9235). If less than $400, **do not** file this schedule; you do not owe self-employment tax ▶	4	
5	**Self-employment tax.** If the amount on line 4 is: • $102,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on **Form 1040, line 57.** • More than $102,000, multiply line 4 by 2.9% (.029). Then, add $12,648 to the result. Enter the total here and on **Form 1040, line 57**	5	
6	**Deduction for one-half of self-employment tax.** Multiply line 5 by 50% (.5). Enter the result here and on **Form 1040, line 27** — 6		

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11358Z **Schedule SE (Form 1040) 2008**

Contributions of Real Property

The special rule encouraging contributions of capital gains real property for conservation purposes is extended. This is effective for contributions made in taxable years beginning after December 31, 2007, and before January 1, 2010.[3]

Endangered Species Recovery Expenditures

A deduction for endangered species recovery expenses is available for expenditures paid or incurred after May 22, 2008. The provision applies to expenditures that are paid or incurred by a taxpayer engaged in the business of farming for the purpose of achieving site-specific management actions pursuant to the Endangered Species Act of 1973.[4] Such expenditures are treated the same as expenditures for the purpose of soil and water conservation made to land used in farming or for the prevention of erosion of land used in farming.[5]

Timber Provisions

The 2008 Farm Bill contains two major provisions relating to timber. One is a temporary reduction in the corporate tax rate for qualified timber gain, and the other is a reduction in the holding-period requirement applicable for real estate investment trusts.[6]

Tax-Rate Reduction. For tax years ending after May 22, 2008, and beginning on or before May 23, 2009, a 15% alternative tax applies to the portion of a corporation's taxable income that consists of qualified timber gain (or, if less, the net capital gain) for a tax year.

The Act also includes detailed changes for real estate investment trusts (REITs) holding timber property. For example, timber gain is included under IRC §631(a) as a category of statutorily-recognized qualified real estate income of a REIT if the cutting is provided by a taxable REIT subsidiary. It also includes gain recognized under IRC §631(b). The otherwise applicable 1-year holding period does not apply.

Holding Period. For sales to a qualified organization for conservation purposes, the bill reduces the holding-period requirement[7] from four years to two years. The holding-period requirement provides a safe harbor from prohibited-transaction treatment for certain timber property sales. The REIT changes apply to tax years beginning after May 23, 2008, but do not apply after the last day of the first tax year beginning after May 23, 2008.

Tax Credit Bonds

The 2008 Farm Bill creates a new category of tax credit bonds called **qualified forestry conservation bonds.** A qualified forestry conservation bond must be issued by a state or an IRC §501(c)(3) organization and must be used to finance a qualified forestry conservation project. The provision is effective for bonds issued after May 22, 2008.[8]

A **qualified forestry conservation project** refers to forest land in which:

- Some portion of the land acquired is adjacent to U.S. Forest Service land;
- At least 50% of the land acquired is transferred to the U.S. Forest Service at no net cost and not more than half of the land acquired may either remain with or be donated to a state;
- All the land must be subject to a habitat conservation plan for native fish approved by the U.S. Fish and Wildlife Service; and
- The amount of acreage must be at least 400 acres.

3. Section 15302 of the FCEA, amending IRC §170
4. Section 15303 of the FCEA, amending IRC §175
5. IRC §175
6. Sections 15311–15315 of the FCEA, amending IRC §§856, 857, and 1201
7. IRC §857(b)(6)(D)
8. Section 15316 of the FCEA, creating new IRC §§54A and 54B

In addition, the Act provides:

- A national limitation on qualified forestry conservation bonds of $500 million;
- That all the available project proceeds must be used within the 3-year period that begins on the date of issuance; and
- That the issuer receiving an allocation to issue qualified forestry conservation bonds may, in lieu of issuing bonds, elect to treat such allocation as a deemed payment of tax that is equal to 50% of the amount of the allocation.

Observation. The provision included in the 2008 Farm Bill by Senator Max Baucus (D-MT) appears to apply to only one private landowner in the United States — the Plum Creek Timber Company (Montana's largest private landowner). The company had planned to sell about 300,000 acres of land in Montana for approximately $500 million. It is anticipated that bonds will cover about half of the purchase price. State and private money is being sought for the balance of the purchase price. The Nature Conservancy has made application for the bonds.

ENERGY-RELATED PROVISIONS

Credit for the Production of Cellulosic Biofuel[9]

This credit is effective for fuel produced after December 31, 2008, and before January 1, 2013. It is a **nonrefundable income tax credit** for the fuel producer. It applies to each gallon of **qualified cellulosic fuel** production for the tax year. The amount of the credit per gallon is $1.01.

For cellulosic biofuel that is **alcohol,** the $1.01 credit amount is **reduced** by the sum of the credit amount applicable for such alcohol under the alcohol mixture credit in effect at the time cellulosic biofuel is produced.[10] If the cellulosic biofuel is **ethanol,** the credit amount for small ethanol producers is what is in effect at the time the cellulosic biofuel fuel is produced.[11]

The reduction applies regardless of whether the producer claims the alcohol mixture credit or small ethanol producer credit for the cellulosic alcohol. When the alcohol mixture credit and small ethanol producer credit expire after 2010, cellulosic biofuel will receive the $1.01 credit amount without reduction.

For the small ethanol producer tax credit, the 15-million-gallon limitation is waived for cellulosic biofuel that is ethanol. Consequently, the small ethanol producer credit may be claimed for cellulosic ethanol in excess of 15 million gallons. The other requirements for the small ethanol producer credit continue to apply for ethanol other than cellulosic ethanol, including the 15-million-gallon limitation.

Cellulosic biofuel and alcohols cannot qualify as biodiesel, renewable diesel, or alternative fuel for purposes of the credit and payment provisions relating to those fuels to eliminate any double benefit.

---

9. Section 15321 of the FCEA, amending IRC §40

10. IRC §40(b)(1)

11. IRC §§40(b)(4) and 40(b)(6)(B)

Cellulosic biofuel is any liquid fuel that:

- Is produced in the United States and used as fuel in the United States (including possessions of the United States);
- Is derived from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis (e.g., dedicated energy crops and trees, wood and wood residues, plants, grasses, agricultural residues, animal wastes, and other waste materials and municipal solid waste); and
- Meets the registration requirements for fuels and fuel additives established by the EPA under Section 211 of the Clean Air Act (i.e., approved by the EPA).

Qualified cellulosic biofuel is defined as any cellulosic biofuel that the taxpayer either produces and uses in his trade or business, or produces and sells to another person for the following purposes:

- For use by the other person in the production of a qualified biofuel mixture in such person's trade or business (other than casual off-farm production)
- For use by the other person as a fuel in a trade or business
- For use selling biofuel at retail to another person and placing the biofuel in the fuel tank of such other person

> **Note.** Cellulosic biofuel producers must register with the IRS. The credit cannot be claimed unless the taxpayer is registered as a producer of cellulosic biofuel.

Modification of the Alcohol Credit[12]

While the provision is effective May 22, 2008, the impact of the change is effective for calendar year 2009 and thereafter.

The $0.51 per gallon incentive (credit) for ethanol is reduced to $0.45 per gallon for calendar year 2009 and thereafter, and the low-proof blender amount is adjusted accordingly to $0.3333.

> **Note.** If 7.5 billion gallons of ethanol (including cellulosic ethanol) are not produced in, or imported to, the United States in 2008, the reduction in the credit amount will be delayed. If the determination is made after the start of a calendar year, taxpayers claiming the reduced amount before the determination will be entitled to the difference between the correct credit amount for that year and the credit amount claimed (e.g., between $0.51 per gallon and $0.45 per gallon).

11

Calculation of the Volume of Alcohol for Fuel Credits. The existing per-gallon credit for the volume of alcohol (including any denaturant) used as a fuel or in a qualified mixture is modified such that the amount of allowable denaturants cannot exceed 2% of the volume of the alcohol. This provision is effective for fuel sold or used after December 31, 2008.[13]

Extension of the Ethanol Tariff. The $0.54 per gallon tariff on imports of ethyl alcohol, and on any mixture containing ethyl alcohol if used as a fuel or in producing a mixture to be used as a fuel that enters the United States, is extended through 2010. This is effective May 22, 2008.[14]

---

12. Section 15331 of the FCEA, amending IRC §§40 and 6426
13. Section 15332 of the FCEA, amending IRC §40
14. Section 15333 of the FCEA

Modification of the Advanced Coal Project Credit and the Gasification Project Credit

Under previous legislation, credits are available for advanced coal and gasification projects. Congress directed the IRS, under certain circumstances, to change the terms of the competitive certification awards and associated closing agreements. This provision is effective for credit allocation awards issued any time before, on, or after May 22, 2008.[15]

FARM-RELATED PROVISIONS

Qualified Small-Issue Bonds for First-Time Farmers

The 2008 Farm Bill increases the maximum amount of qualified small-issue bond proceeds available to first-time farmers to $450,000 and indexes the amount for inflation. This provision is effective for bonds issued after May 22, 2008.[16]

Qualified small-issue bonds are tax-exempt bonds issued by state and local governments to finance private business manufacturing facilities, or to finance the acquisition of land and equipment by certain first-time farmers. In order for first-time farmers to qualify, the individual must not have:

- Had any direct ownership interest in substantial farmland in which the individual materially participated; or
- Received more than $250,000 in qualified small-issue bond financing.

Substantial farmland was defined as any parcel of land unless the parcel is smaller than 30% of the median size of a farm in the county in which the parcel is located, and its FMV does not at any time while held by the individual exceed $125,000. The Farm Bill eliminates the FMV test from the definition.

Like-Kind Treatment for Certain Mutual Ditch, Reservoir, or Irrigation Company Stock

Current Law. In general, IRC §1031(a)(2) tax-deferred treatment does not apply to any exchange of stock in trade or other property held primarily for sale; stocks, bonds or notes; other securities or evidence of indebtedness or interest; interests in a partnership; certificate of trust or beneficial interests; or choses in action.

Farm Bill Provision.[17] For transfers made after May 22, 2008, tax-deferred treatment applies to shares in a mutual ditch, reservoir, or irrigation company, if at the time of the exchange:

1. The company is an organization described in IRC §501(c)(12)(A) (determined without regard to the percentage of its income that is collected from its members for the purpose of meeting losses and expenses); and
2. The shares in the company are recognized by the highest court of the state in which the company was organized, or by applicable state statute, as constituting or representing real property or an interest in real property.

Creation of an Agricultural Chemicals Security Tax Credit

A new 30% credit for **qualified chemical security expenditures** was created. The credit is a component of the general business credit and is limited to $100,000 per facility with each taxpayer's annual credit limited to $2 million. A taxpayer's deductible expense is reduced by the amount of the credit claimed. This provision is effective for expenses paid or incurred after May 22, 2008, and before December 31, 2012.[18]

---

15. Section 15346 of the FCEA, modifying IRC §§48A and 48B
16. Section 15341 of the FCEA, amending IRC §144
17. Section 15342 of the FCEA, amending IRC §1031
18. Section 15343 of the FCEA, creating IRC §38(b)(1)

Qualified chemical security expenditures incurred by an **eligible agricultural business** are amounts paid for the following:

- Employee security training and background checks;
- Limitation and prevention of access to controls of specific agricultural chemicals stored at a facility;
- Tagging, locking tank valves, and chemical additives to prevent the theft of specific agricultural chemicals or to render such chemicals unfit for illegal use;
- Protection of the perimeter of areas where specified agricultural chemicals are stored;
- Installation of security lighting, cameras, recording equipment, and intrusion-detection sensors;
- Implementation of measures to increase computer or computer-network security;
- Security vulnerability assessments;
- Implementing site security plans; and
- Other measures provided for by regulation.

Eligible agricultural businesses are those that:

- Sell agricultural products, including specified agricultural chemicals, at retail predominantly to farmers and ranchers; or
- Manufacture, formulate, distribute, or aerially apply specified agricultural chemicals.

Specified agricultural chemicals are defined as:

- Fertilizer commonly used in agricultural operations that are listed under §302(a)(2) of the Emergency Planning and Community Right-to-Know Act of 1986; section 101 or part 172 of title 49, Code of Federal Regulations; or part 126, 127 or 154 of title 33, Code of Federal Regulations; and
- Any pesticide (as defined in section 2(u) of FIFRA), including all active and inert ingredients which are used on crops grown for food, feed, or fiber.

3-Year Depreciation for All Race Horses

The 2008 Farm Bill changed the recovery period for race horses to three years. This provision is effective for any race horse that is two years old or younger at the time that it is placed in service after December 31, 2008, and before January 1, 2014.[19]

> **Note.** Under prior law, a 7-year MACRS recovery period was assigned to any race horse two years old or younger at the time that it was placed in service, but a 3-year MACRS recovery period was assigned to any race horse more than two years old at the time it was placed in service. The provision effectively creates a single 3-year MACRS recovery period for all race horses.

19. Section 15344 of the FCEA, amending IRC §168

Limitation on Farming Losses of Certain Taxpayers[20]

If a taxpayer (other than a C corporation) receives farm subsidies, the amount of farming losses that a taxpayer may use to reduce other income is limited to the greater of $300,000 (MFJ) or the taxpayer's total net farm income for the prior five taxable years. The subsidies include any direct or counter-cyclical payments under Title I of the 2008 Farm Bill or any CCC loan. This provision is effective for taxable years beginning after December 31, 2009.

Total net farm income is defined as the aggregate of all income and loss from farming businesses for the prior five taxable years. For purposes of calculating total net farm income for the prior five years, losses that are limited under the provision are taken into account in the year in which they are allowed as a deduction.

> **Example 5.** Frank and Mary, a farming couple, have a $500,000 excess farming loss in 2010 that is not allowed as a deduction until 2012. The calculation in 2011 of total net farm income for the prior five years does not take into account the $500,000 as a farm loss. Instead, the $500,000 loss is included in the calculation of the prior year's total net farm income for taxable years 2013 through 2017.

For partnerships and S corporations, the limit is applied at the partner or shareholder level. Thus, each partner or shareholder takes into account its proportionate share of income, gain, or deduction from farming businesses of a partnership or S corporation. This includes any applicable subsidies received by a partnership or S corporation during the taxable year, regardless of whether such items are treated as income for federal tax purposes.

Farming business is defined in accordance with IRC §263A(e)(4), except that the processing of commodities is included in the definition.

As applied to cooperatives, the farming activities of a cooperative are attributed to each member for purposes of the definition of a farming business. Thus, a member of a cooperative who raises a commodity and sells it to the cooperative for processing is considered the processor of the commodity. Accordingly, patronage dividends received from a cooperative that is engaged in a farming business are considered income from a farming business.

Any loss that is disallowed under the provision in a particular year is carried forward to the next taxable year and treated as a deduction attributable to farming businesses in that year.

Farming losses resulting from disease, drought, fire, storm, or other casualty are disregarded for purposes of calculating the limitation.

20. Section 15351 of the FCEA, modifying IRC §461

Optional Method of Calculating SE Tax

The 2008 Farm Bill increased the dollar thresholds for the farm optional method and nonfarm optional method for computing net earnings from self-employment. It also makes these thresholds subject to annual indexing. This provision is effective for taxable years beginning after December 31, 2007.[21]

An individual may elect to use either the farm optional method or nonfarm optional method when calculating net earnings from self-employment for SECA purposes. The farm optional method allows individuals to pay SECA taxes (and secure social security benefit coverage) when they have low net income or losses from farming. The nonfarm optional method is similar to the farm optional method. For tax years beginning after 2007, taxpayers electing the farm optional method are eligible to secure four credits of social security benefit coverage each tax year by increasing and indexing the applicable thresholds. Similar modifications are made to the nonfarm optional method.

Note. Under the old law, if gross income is $2,400 or less, a farmer could report two-thirds of gross income as SE income. If gross income was more than $2,400 and net earnings from self-employment was less than $1,600, a farmer could report $1,600 as SE income. Under the Farm Bill provision, the $2,400 amount is replaced by an upper limit which is 150% of the sum of the amount required under Section 213(d) of the Social Security Act for a quarter of coverage, or $1,050 in 2008.

The maximum income for the optional method increased from $1,600 in 2007 to $4,200 in 2008. A taxpayer choosing the optional method would have paid $245 in 2007 and will pay $643 in 2008. While electing the optional method increases a taxpayer's SE tax, many times the tax increase is offset by an earned income credit.

11

21. Section 15352 of the FCEA, amending IRC §1402(a)

Schedule SE (Form 1040) 2008 | Attachment Sequence No. 17 | Page 2

Name of person with **self-employment** income (as shown on Form 1040) | Social security number of person with **self-employment** income ▶

Section B—Long Schedule SE

Part I Self-Employment Tax

Note. If your only income subject to self-employment tax is **church employee income,** skip lines 1 through 4b. Enter -0- on line 4c and go to line 5a. Income from services you performed as a minister or a member of a religious order **is not** church employee income. See page SE-1.

A If you are a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361, but you had $400 or more of **other** net earnings from self-employment, check here and continue with Part I . . . . ▶ ☐

1a	Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A. **Note.** Skip lines 1a and 1b if you use the farm optional method (see page SE-4)	1a	
b	If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 6b, or listed on Schedule K-1 (Form 1065), box 20, code X	1b	( )
2	Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see page SE-1 for types of income to report on this line. See page SE-3 for other income to report. **Note.** Skip this line if you use the nonfarm optional method (see page SE-4)	2	
3	Combine lines 1a, 1b, and 2	3	
4a	If line 3 is more than zero, multiply line 3 by 92.35% (.9235). Otherwise, enter amount from line 3	4a	
b	If you elect one or both of the optional methods, enter the total of lines 15 and 17 here	4b	
c	Combine lines 4a and 4b. If less than $400, **stop**; you do not owe self-employment tax. **Exception.** If less than $400 and you had **church employee income,** enter -0- and continue ▶	4c	
5a	Enter your **church employee income** from Form W-2. See page SE-1 for definition of church employee income . . . **5a** ____		
b	Multiply line 5a by 92.35% (.9235). If less than $100, enter -0-	5b	
6	**Net earnings from self-employment.** Add lines 4c and 5b	6	
7	Maximum amount of combined wages and self-employment earnings subject to social security tax or the 6.2% portion of the 7.65% railroad retirement (tier 1) tax for 2008	7	102,000 00
8a	Total social security wages and tips (total of boxes 3 and 7 on Form(s) W-2) and railroad retirement (tier 1) compensation. If $102,000 or more, skip lines 8b through 10, and go to line 11 . . . **8a** ____		
b	Unreported tips subject to social security tax (from Form 4137, line 10) . . . **8b** ____		
c	Wages subject to social security tax (from Form 8919, line 10) . . . **8c** ____		
d	Add lines 8a, 8b, and 8c	8d	
9	Subtract line 8d from line 7. If zero or less, enter -0- here and on line 10 and go to line 11 ▶	9	
10	Multiply the **smaller** of line 6 or line 9 by 12.4% (.124)	10	
11	Multiply line 6 by 2.9% (.029)	11	
12	**Self-employment tax.** Add lines 10 and 11. Enter here and on **Form 1040, line 57**	12	
13	**Deduction for one-half of self-employment tax.** Multiply line 12 by 50% (.5). Enter the result here and on **Form 1040, line 27** . . . **13** ____		

Part II Optional Methods To Figure Net Earnings (see page SE-4)

Farm Optional Method. You may use this method **only** if **(a)** your gross farm income[1] was not more than $6,300, **or (b)** your net farm profits[2] were less than $4,548.

14	Maximum income for optional methods	14	4,200 00
15	Enter the **smaller** of: two-thirds (⅔) of gross farm income[1] (not less than zero) **or** $4,200. Also include this amount on line 4b above	15	

Nonfarm Optional Method. You may use this method **only** if **(a)** your net nonfarm profits[3] were less than $4,548 and also less than 72.189% of your gross nonfarm income,[4] **and (b)** you had net earnings from self-employment of at least $400 in 2 of the prior 3 years.

Caution. You may use this method no more than five times.

16	Subtract line 15 from line 14	16	
17	Enter the **smaller** of: two-thirds (⅔) of gross nonfarm income[4] (not less than zero) **or** the amount on line 16. Also include this amount on line 4b above	17	

[1] From Sch. F, line 11, and Sch. K-1 (Form 1065), box 14, code B.

[2] From Sch. F, line 36, and Sch. K-1 (Form 1065), box 14, code A—minus the amount you would have entered on line 1b had you not used the optional method.

[3] From Sch. C, line 31; Sch. C-EZ, line 3; Sch. K-1 (Form 1065), box 14, code A; and Sch. K-1 (Form 1065-B), box 9, code J1.

[4] From Sch. C, line 7; Sch. C-EZ, line 1; Sch. K-1 (Form 1065), box 14, code C; and Sch. K-1 (Form 1065-B), box 9, code J2.

Schedule SE (Form 1040) 2008

Information Reporting for Commodity Credit Corporation (CCC) Transactions

For loans repaid on or after January 1, 2007, IRS Notice 2007-63 provides that the CCC reports market gain associated with the repayment of a CCC loan irrespective of whether the taxpayer repays the loan with cash or uses CCC certificates in repayment of the loan. The CCC reports the market gain on Form 1099-G. This provision is effective for loans repaid on or after January 1, 2007.[22]

GO-ZONE-STYLE TAX BREAKS FOR KIOWA COUNTY, KANSAS AND SURROUNDING AREA

For purposes of the 2008 Farm Bill, "Kansas disaster area" means an area declared a major disaster by the president under Section 401 of the Robert T. Stafford Disaster Relief and Emergency Act (FEMA-1699-DR, as in effect on May 22, 2008) by reason of severe storms and tornados beginning on May 4, 2007. The area was determined by the president to warrant individual assistance or individual and public assistance from the federal government for damages attributable to storms and tornados. Some of the tax benefits available to the victims of hurricanes Katrina, Wilma, and Rita have been extended to the victims in the Kansas disaster area.[23]

For losses arising after May 3, 2007, personal casualty or theft losses are deductible without regard to either the $100 limitation or the 10% of AGI limitation.

The replacement period for involuntarily converted property for nonrecognition of gain purposes is extended from two to five years. Substantially all of the use of the replacement property must be in the Kansas disaster area. This is effective May 22, 2008.

The employee retention credit (applicable to employers impacted by Hurricanes Rita, Wilma, and Katrina) is extended to the Kansas disaster area. The credit provides a 40% credit of the qualified wages paid by an eligible employer to an eligible employee.[24] The credit applies up to a maximum of $6,000 in qualified wages per employee. For the Kansas disaster area, the credit only applies to eligible employers who employed an average of not more than 200 employees on business days during the taxable year before May 4, 2007. The effective date is May 22, 2008.

Additional 50% bonus first-year depreciation is available for property that meets the following requirements:

- The property must be property to which the general MACRS rules apply:
  - Applicable recovery period of 20 years or less;
  - Computer software other than computer software covered by IRC §197;
  - Water utility property;
  - Certain leasehold improvement property; or
  - Certain nonresidential real property and residential rental property.
- Substantially all the use of the property must be in the Kansas disaster area and be used in the active conduct of the taxpayer's trade or business.
- The property's original use must commence with the taxpayer on or after May 5, 2007.

---

22. Section 15353 of the FCEA, creating new IRC §6039J
23. Section 15345 of the FCEA, amending IRC §1400S(b)
24. IRC §1400R

- The property must be acquired by purchase (as defined by IRC §179(d)) by the taxpayer on or after May 5, 2007, and placed in service on or before December 31, 2008 (December 31, 2009, for qualifying nonresidential real property and residential rental property).

Note. Property does not qualify if a binding written contract for the acquisition of such property was in effect before May 5, 2007. However, property is not precluded from qualifying for bonus depreciation merely because a binding written contract to acquire a component of the property is in effect before May 5, 2007.

- Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after May 4, 2007, and before January 1, 2009, and the property is placed in service on or before December 31, 2008 (and all other requirements are met).
- Expense-method depreciation is increased by the lesser of $100,000 or the cost of qualified property for the taxable year that is acquired on or after May 5, 2007, and placed in service on or before December 31, 2008. The threshold for reducing the amount expensed is the lesser of $600,000 or the cost of the qualified property placed in service during the tax year. For purposes of the provision, qualified property must:
  - Have an applicable recovery period of 20 years or less;
  - Be computer software other than computer software covered by IRC §197;
  - Be water utility property; or
  - Be certain leasehold improvement property
- Substantially all the use of the property must be in the Kansas disaster area and be used in the active conduct of the taxpayer's trade or business. Likewise, the original use of the property must commence with the taxpayer on or after May 5, 2007, and the taxpayer must acquire the property by purchase on or after May 5, 2007. However, no binding contract for the acquisition could be in effect before May 5, 2007, and the property must be placed in service by the taxpayer on or before December 31, 2008.

Enhanced expensing is available for certain demolition and clean-up costs of up to 50% of any qualified recovery assistance clean-up cost paid or incurred during the period beginning on May 4, 2007, and ending on December 31, 2009:

- The remaining 50% is capitalized into the taxpayer's basis in the land on which the structure is located.
- A **qualified recovery assistance clean-up cost** is an amount paid or incurred for the removal of debris from, or the demolition of structures on, real property located in the Kansas disaster area to the extent that the amount would otherwise be capitalized.
- To qualify, the property must be held for use in a trade or business, for the production of income, or as inventory.

Special tax treatment of public utility property disaster losses is available. Taxpayers incurring casualty losses attributable to the Kansas storms and tornados with respect to public utility property located in the Kansas disaster area may make an election to take such losses into account in the fifth taxable year (rather than the first) immediately preceding the taxable year in which the loss occurred.

Note. If application of the election results in the creation or increase of a net operating loss for the year in which the casualty loss is taken into account, the net operating loss may be carried back or carried over subject to the usual rules for net operating losses.

- Special treatment for NOLs attributable to storm losses is available. The provision mirrors the rules provided for GO-Zone losses under IRC §1400N(k).
- Use of retirement funds from retirement plans is available. The legislation provides relief similar to the relief provided in IRC §1400Q with respect to use of retirement funds in connection with the tornadoes and storms occurring in the Kansas disaster area.

Note. The Kansas Disaster Area consists of 24 Kansas counties. Complete information regarding the provisions is available in IRS Pub. 4492-A, *Information for Taxpayers Affected by the May 4, 2007, Kansas Storms and Tornadoes*.

Other Provisions

In order to meet budgetary requirements of the 2008 Farm Bill, Congress changed the estimated income tax payment rules for large corporations. Large corporations are those with over $1 billion in assets. This payment change does not occur until 2012.

The required estimated payment due in July, August, or September of 2012 is increased to 125% of the amount otherwise due. However, the next payment due in October, November, or December is reduced to 75%.[25]

Note. This is the sixth time estimated payments for large corporations have been changed since 2005.

HEROES EARNINGS ASSISTANCE AND RELIEF TAX ACT OF 2008

In a continuing effort to recognize the services of active military personnel, veterans, firefighters, and emergency responders, Congress passed the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act). The Act also includes provisions beneficial to Peace Corps volunteers and members of the intelligence community.

STIMULUS PAYMENTS

The ESA provides a refundable credit to taxpayers who file a tax return and have income under a certain level. However, to receive the refund, the taxpayers must have valid social security numbers. This includes the taxpayer and spouse if filing a joint return and all children claimed as dependents. The HEART Act allows these couples to file jointly and receive a stimulus payment if one of them is a member of the Armed Forces of the United States, and one of them has a valid social security number. This includes both regular and reserve members.

The provision is effective on February 13, 2008.[26]

COMPENSATION PROVISIONS

Congress also included provisions dealing with military members' compensation.

Combat Pay

The first provision permanently extends the election to treat combat pay as earned income for purposes of the earned income credit. Typically, the earned income credit is not available on nontaxable income. This election was originally added by the Working Families Tax Relief Act of 2004. The provision was temporary but has been extended in two different acts. The provision is now permanent.

This provision is effective for tax years ending after December 31, 2007.[27]

25. Section 15202 of the FCEA
26. Section 101(b) of the HEART Act
27. Section 102(d) of the HEART Act

Differential Wage Payments

To recognize the service of an employee who is a member of the National Guard or Reserves and is called to active duty, some employers pay the employee the difference between the compensation they would receive if on the job and what they receive in military compensation. This is termed **differential military pay.**

Prior to passage of the HEART Act, the differential military pay was reported on Form 1099-MISC rather than Form W-2 because the recipient was no longer an employee of the company. As such, the compensation was not subject to income tax withholding because the employment relationship was terminated at the time the employee was called to active duty. Consequently, the pay was not eligible for inclusion in compensation used to calculate retirement benefits.

With passage of the new law, differential wage payments are subject to withholding and are eligible for several types of retirement plans. To qualify as a differential wage payment, the employee must be on active duty for more than 30 days and the payment must represent all or a portion of the wages the person would have received if working for the employer.

If the person receives plan distributions during the time he is on active duty, the distribution is not considered an in-service distribution. Instead, it is treated as a distribution made to a severed employee. This applies to distributions from the following plans:

- IRC §401(k)
- IRC §403(b)
- Tax-sheltered annuities
- IRC §457

However, the employee is not permitted to make any contributions or elective deferrals for six months following the distribution.

Differential wage payments qualify as compensation for IRA contributions.

This provision is effective for distributions received after December 31, 2008. The withholding provision is effective for years beginning after December 31, 2008.[28]

State and Local Bonuses

Qualified military benefits are excluded from gross income for tax purposes. These may be either in-kind benefits or allowances. They include such benefits as military housing, moving, and travel allowances. However, payments made to members of the military by state and local governments are not excluded.

The IRS ruled bonuses paid to military veterans in 1968 were gifts rather than compensation.

The HEART Act includes state and local government bonus payments to a member or former member of the uniformed services or to a dependent as a **qualified military benefit.** Consequently, the bonus is excluded from gross income. The payment must be on account of the taxpayer's service in a combat zone.

The provision applies to all qualified payments. This provision is effective for payments made on or after the date of enactment.[29]

---

28. Section 105(b)(3) of the HEART Act

29. Section 112(a) of the HEART Act

Wages to Volunteer Firefighters and Emergency Responders

The change made by the HEART Act is described in the Mortgage Forgiveness Debt Relief Act of 2007, discussed earlier.

OTHER PROVISIONS

Deadline for Refund Claims

The government provides length-of-service retirement benefits and disability retirement benefits to former military personnel. The length-of-service benefits are included in the recipient's gross income. However, disability benefits are excluded from gross income. There are times when the retiree challenges the classification of the benefit received and it is recategorized from length-of-service benefit to disability benefit. When this happens, the retiree is allowed to file an amended return and to exclude the benefit. Under the present law, he is subject to the normal statute of limitations for filing an amended return, which is three years from the date of filing or two years from the date of payment. Consequently, many retirees who have their benefits reclassified are unable to receive a refund.

The HEART Act extends the statute of limitations to one year following the date of reclassification if that date is after the normal 3-year limitation.

This provision is effective on the date of enactment.[30]

Retirement Plans

The Pension Protection Act of 2006 contained a provision waiving the 10% early-distribution penalty for reservists called to active duty for a period of 179 or more days. Even if the reservist is under age 59½, he may receive a distribution from an IRA, 401(k), 403(b), or similar retirement plan and not be subject to the early-distribution penalty. The distribution may be repaid during a 2-year time period after the taxpayer returns from active duty. These rules only applied to reservists called to active duty prior to December 31, 2007.

The HEART Act makes these rules permanent. They are effective for individuals called to active duty after December 31, 2007.[31]

Death Gratuity and SGLI Payments

Survivors of individuals who die while on active duty or on inactive duty training receive a death gratuity from the government. The survivor may also receive a payment from the Servicemembers' Group Life Insurance (SGLI) program. These payments are excluded from gross income. The HEART Act now allows these payments to be contributed to a Roth IRA or a Coverdell ESA regardless of other contribution limits.

Contribution of the benefit by the survivor to a Roth IRA is treated the same as a rollover contribution. The contribution must be made within one year of the receipt of the benefit and cannot exceed the amount of the benefit received. If a portion of the benefits are contributed to a Coverdell ESA, that portion reduces the amount that may be contributed to the Roth IRA.

Caution. While the Act allows a contribution to the Roth IRA or Coverdell ESA, the normal distribution rules apply. Therefore, withdrawals in excess of basis are taxable for taxpayers under age 59½. Withdrawals made within five years from the date of contribution are also taxable.

This provision is effective for deaths resulting from injuries occurring on or after the date of enactment. The provision also applies to benefits received for injuries occurring between October 7, 2001 and the date of enactment, if the contributions are made within one year after the date of enactment.[32]

30. Section 106(a) of the HEART Act

31. Section 107(a) of the HEART Act

32. Section 109(a) of the HEART Act

Flexible Spending Account Distributions

Employees who have a health flexible spending account (FSA) with their employer must make withdrawals within 2½ months after the end of the plan year. The distributions must be for health purposes.

The Act allows **reservists** that are called to active duty for a period of more than 179 days to make withdrawals regardless of the purpose. The withdrawal must be made within 2½ months of the end of the plan year.

This is effective for distributions made after the date of enactment.[33]

Gain on Sale of Principal Residence for Peace Corps Members

Due to prior legislation, the testing period for the sale of a principal residence was extended for active-duty military personnel, members of the U.S. Foreign Service, and certain members of the intelligence community serving outside of the United States. To qualify for the IRC §121 exclusion, when using the two-out-of-five-year rule, the 5-year period was extended by five years. The HEART Act extends the 5-year period for members or spouses of members of the Peace Corps serving outside the United States.

This provision is effective for years beginning after December 31, 2007.[34]

Gain on Sale of Principal Residence for Intelligence Community

The IRC §121 rule regarding gain on the sale of a principal residence for the intelligence community was changed. Under the old law, the member had to be at a duty station outside of the United States for the 5-year extension to apply. In addition, the exclusion was scheduled to expire for sales or exchanges occurring after December 31, 2010.

The HEART Act no longer requires the duty station be outside the United States. The exclusion is available as long as the post of duty is at least 50 miles from the principal residence. This is now a permanent exclusion with no expiration date. This provision is effective for sales and exchanges after the date of enactment.[35]

Survivor and Disability Benefits

Some retirement plans offer additional benefits to employees who die or become disabled during their time of employment. The HEART Act requires employers to offer these same benefits to the survivor of an employee killed while on active duty and to an employee disabled while on active duty.

This provision is effective for deaths or disabilities occurring on or after January 1, 2007.[36]

Veterans' Mortgage Bonds

Lower- and middle-income taxpayers can obtain a subsidized loan from some state and local governments if they are first-time home buyers. The use of these subsidized bonds is now available to certain veterans. The veteran must have served in the active military and not have received a dishonorable discharge. There is no requirement that the veteran be a first-time home buyer.

This provision is made permanent and is effective for qualified mortgage bonds issued after December 31, 2007.[37]

---

33. Section 114(a) of the HEART Act
34. Section 110(a) of the HEART Act
35. Section 113(c) of the HEART Act
36. Section 104(a) of the HEART Act
37. Section 103(a) of the HEART Act

Failure-to-File Penalty

Currently, failing to file a tax return by the due date results in a penalty of 5% for the first month and an additional 5% for each additional month or partial month. The maximum penalty is 25%. The penalty only applies if there is an underpayment of tax and may be abated for reasonable cause.

Under the new law, the minimum penalty is increased to the lesser of 100% of the net amount of tax due or $135 if the return is not filed within 60 days of the filing deadline.

This provision is effective for returns due after December 31, 2008.[38]

Return Disclosures

The disclosure of tax-return information is normally prohibited. However, current law permits certain agencies to receive information from the Social Security Administration and the Treasury Secretary for the purpose of determining program eligibility benefits from certain federally-assisted programs. The provision permitting veterans' programs to receive information was scheduled to terminate on September 30, 2008.

The HEART Act allows permanent access for these veterans' programs. This provision is effective for requests made after September 30, 2008.[39]

Mental-Health Insurance Benefits

Many group health plans place annual and aggregate limits on medical and surgical benefits. The current law requires the same limits to apply to mental-health benefits if they are also covered by the plan. This provision expired on January 1, 2008. However, there is no requirement that the plans offer mental-health benefits. The new law extends the excise tax on employers of $100 per day for each day of noncompliance, through December 31, 2008.

FOREIGN PROVISIONS

Deemed Sale of Expatriate Assets

Some taxpayers relinquish their U.S. citizenship in order to avoid U.S. taxes. The same has happened with long-term residents of the United States. Therefore, Congress tightened the rules on expatriation in order to prevent this abuse. There are several exceptions to the new rules, but they are too numerous to discuss in this chapter.

The basic premise of the new law is that the FMV of all of the expatriate's assets must be valued as of the day before the expatriation date. The net unrealized gain on this property is calculated using this mark-to-market value. The gain is then treated as a deemed sale of the assets and taken into account in that year.

This provision is effective for expatriations of individuals with net worth of $2 million or more on or after the date of enactment.[40]

Gifts and Bequests from Expatriates

Under prior law for U.S. citizens, asset gifts, bequests, and inheritances are excluded from the recipient's gross income. However, any income earned on the asset is taxable to the individual. Any transfers of tangible property located in the United States by a nonresident are subject to gift tax. Intangible property located in the United States held by a foreign corporation is subject to gift tax only if the nonresident noncitizen is an expatriate.

---

38. Section 303(a) of the HEART Act

39. Section 108(c) of the HEART Act

40. Section 877A(g)(3) of the HEART Act

Under the new law, a U.S. citizen or resident is taxed on gifts and inheritances from covered expatriates. The tax is based on the value of the gift or inheritance multiplied by the highest estate-tax rate. For 2008, this is 45%. Gifts under the annual gift-tax exclusion (currently $12,000) are exempt from the tax. The tax is reduced by any gift or estate tax paid to a foreign country on the assets.

The new law is effective for gifts and bequests received on or after the date of enactment.[41]

HOUSING ASSISTANCE TAX ACT OF 2008

The Housing Assistance Tax Act of 2008 (HATA) is part of the much larger Housing and Economic Recovery Act of 2008 (P.L. 110-289). The bill was signed by President Bush on July 30, 2008. The HATA benefits many individuals, businesses, government, and tax-exempt entities. The HATA also contains revenue raisers implemented to offset the $15.1 billion of tax relief. The following provides a brief summary of the tax provisions.

FIRST-TIME HOME BUYERS

First-time home buyers are entitled to a new refundable tax credit. The credit is the lesser of $7,500 or 10% of the purchase price of a principal residence.[42] Married filing separately (MFS) taxpayers are eligible for a $3,750 refundable credit. If two or more unmarried taxpayers purchase a principal residence, they qualify for a maximum credit of $7,500. The credit is then allocated among the homeowners. A first-time home buyer is defined as one who has not owned a principal residence in the United States for three years preceding the current purchase.

To qualify for the credit, the new principal residence must be purchased between April 9, 2008, and June 30, 2009. If a contract was signed for the home's purchase prior to April 9, 2008, the property still qualifies for the credit as long as the taxpayer closes after April 8, 2008. If the taxpayer is building the residence, he must occupy the residence prior to July 1, 2009.

Homes purchased from a spouse, ancestor, or lineal descendent do not qualify for the credit. Neither do homes acquired by gift or inheritance. Homes in which the seller provides down-payment assistance are also disqualified.

The credit is subject to a phaseout. For MFJ taxpayers, the phaseout begins when MAGI exceeds $150,000. The credit is entirely phased out for MAGIs of $170,000. Taxpayers with other filing statuses are subject to the phaseout for MAGIs between $75,000 and $95,000. No credit is available if the taxpayer is eligible for the D.C. home-buyer credit in the year of purchase or a prior year. Neither nonresident aliens nor taxpayers financing their purchase with tax-exempt mortgage-revenue bonds are eligible for the credit.

Note. The credit is effectively a 15-year interest-free loan because the credit must ultimately be repaid (recaptured).

The recapture is without interest and begins the second year after the principal residence is purchased. The taxpayer increases his federal tax liability by 6.66% of the credit amount each year during the recapture period. The recapture period is defined as the 15 taxable years that begin the second year following the year in which the principal residence for which the credit was allowable was purchased. Recapture also occurs if the residence is sold or ceases to be used as a principal residence. However, the recapture amount is limited to the gain on the property. No recapture is required if the taxpayer dies during the recapture period. There is also no recapture in the event of an involuntary conversion if the replacement is a principal residence purchased within two years.

41. Section 301(b) of the HEART Act

42. Section 3011(c) of the HATA

If the residence is sold to an unrelated party, the amount of recapture is limited by the gain (if any) on the sale. For such sales, the taxpayer's adjusted basis in the residence is reduced by the amount of the credit claimed that has not already been recaptured.

If the principal residence is purchased during the first six months of 2009, the taxpayer can elect to treat the purchase as occurring on December 31, 2008. This allows the taxpayer to not only claim the credit on the 2008 tax return, but to start the recapture period as well.

Example 6. Ryan graduates from college and begins a new job in Kansas City. He becomes aware of the credit and purchases a condo for $100,000 on June 1, 2008. Therefore, he is eligible for the maximum $7,500 refundable credit. He claims this credit on his 2008 income tax return. His basis in the house is now $92,500 ($100,000 – $7,500). Beginning with his 2010 income tax return, he must recapture $500 each year through 2024.

Example 7. Use the same facts as **Example 6,** except Ryan bought the condo on June 1, 2009 rather than June 1, 2008. Ryan is entitled to claim the $7,500 refundable credit on his 2008 original (if not filed yet) or amended tax return.

Example 8. Use the same facts as **Example 6.** In 2011, Ryan has the opportunity to move to New York City. Consequently, he sells the Kansas City condo for $110,000 and moves into an apartment. His gain is $17,000 as calculated below. He is required to recapture $7,000 on his 2011 tax return. This is the $7,500 refundable credit minus the $500 recaptured in 2010. The calculation of gain used to determine the recapture amount is shown below.

Sale price		$110,000
Cost	$100,000	
Less: basis reduction for refundable credit	(7,500)	
Plus: basis increase for 2010 recapture	500	
Adjusted basis	$ 93,000	(93,000)
Gain (> the $7,000 remaining recapture amount)		$ 17,000

Example 9. Use the same facts as **Example 8,** except Ryan sold the condo for $98,000. Ryan's 2011 recapture amount is $5,000, since the recapture is limited to the gain on the property.

TAX-EXEMPT HOUSING BONDS

11

Taxpayers who invested in certain exempt facility bonds used for a qualified residential rental project, qualified mortgage bonds, and qualified veterans' mortgage bonds do not treat the interest received as an AMT preference item. This is effective for bonds issued after July 30, 2008.[43]

Bonds issued by state and local governments after July 30, 2008, and before January 1, 2011, are no longer treated as "federally guaranteed" because of a guarantee by the Federal Home Loan Bank. Therefore, the interest on these loans is excluded from gross income for federal tax purposes.[44]

Bonds issued between May 2008 and December 31, 2010, are not deemed to be private activity bonds if they were used by first-time home buyers for residences located in a presidentially-declared disaster area.[45]

43. Section 3022(d)(3) of the HATA

44. Section 3023(c) of the HATA

45. Section 3026(b) of the HATA

Student Housing Exception

This provision benefits students under the care and placement of a foster-care program administered under the Social Security Act. The rules applicable to qualified residential rental project exempt facility bonds and the low-income housing credit apply with respect to the treatment of these students. This provision is effective for determinations made after July 30, 2008.[46]

NONRESIDENTIAL REAL PROPERTY REHABILITATION CREDIT

Taxpayers that claimed the nonresidential real property rehabilitation credit may now lease 50% of the property to a state or local government or another tax-exempt entity in a disqualified lease without being required to allocate rehabilitation expenses. This reflects an increase from 35% of the property. This provision is effective for expenditures taken into account after December 31, 2007.[47]

PROPERTY TAX STANDARD DEDUCTION

Taxpayers who do not itemize are given an additional standard deduction for state and local property taxes.[48] The deduction is limited to the lesser of $500 or the actual amount of state and local property taxes paid. MFJ taxpayers are eligible for a $1,000 additional standard deduction. The additional deduction is available for tax years beginning in 2008.

LIMITATIONS ON USE OF GAIN EXCLUSION ON PRINCIPAL RESIDENCE

IRC §121 allows taxpayers to exclude up to $500,000 of gain (MFJ) or $250,000 of gain (single filers) on returns when they sell their principal residence. They are required to reside in the property at least two of the last five years with certain exceptions. The HATA makes a major change in the exclusion rules.[49] For sales occurring after December 31, 2008, the §121 gain exclusion is no longer available for periods of "nonqualified use." **The new rules are effective for periods of nonqualified use after December 31, 2008.**

Prior to the HATA, if the residence was used for nonqualified purposes — such as rental property — the exclusion was available, but depreciation recapture was required as long as the other requirements were met. **Therefore, if the property is rented or does not qualify as a principal residence for another reason, the entire §121 exclusion is not available.** Any gain must be allocated based on the percentage of time the residence was used for nonqualifying purposes.

46. Section 3004(i)(4) of the HATA

47. Section 3025(b) of the HATA

48. Section 3012(c) of the HATA

49. Section 3092(b) of the HATA

Example 10. Elmo, a single individual, purchases property on January 1, 2009, for $400,000. He uses it as rental property for two years, claiming $20,000 of depreciation deductions. On January 1, 2011, Elmo converts the property to his principal residence. In January 1, 2013, Elmo moves out. He sells the property for $700,000 on January 1, 2014.

Old Law. Without considering the provisions of the new legislation, Elmo would be required to report the following on his 2014 tax return regarding the sale of the property.[50]

Sale price on January 2014	$700,000
Less: adjusted basis ($400,000 – $20,000 prior depreciation)	(380,000)
Gain	$320,000

His gain under **Old Law** would be allocated as follows:

(1) Total gain	$320,000
(2) Taxable unrecaptured §1250 gain	(20,000)
(3) Taxable §121 long-term gain	(50,000)
§121(a) exclusion (two-out-of-five year test met)	**$250,000**

New Law. Under the new legislation provisions, Elmo must report the following on his 2014 tax return regarding the sale of the property.

His $320,000 gain under **New Law** is identical to that shown under Old Law. It must be allocated as follows:

(1) Total gain	$320,000
(2) Taxable unrecaptured §1250 gain	(20,000)
(3) Taxable §121 long-term gain ($300,000 remaining gain × 40%)	(120,000)
§121(a) exclusion ($300,000 × 60%)	**$180,000**

Note. During the 5-year period ending on the sale date (January 1, 2014), the property was rented for two years. These two years represent "nonqualified use."[51] Therefore, the nonqualified use ratio is 40%. The last year of the 5-year period (January 1, 2013 to January 1, 2014) is not treated as a period of nonqualified use. **Example 11** illustrates provisions of the new law.

11

The definition of "periods of disqualified use" contains certain exceptions:

- When the property is sold, any portion of the 5-year period between the date the home was last used as the principal residence of either the taxpayer or the spouse and the date of sale is not considered nonqualified use.
- Members of the uniformed services, Foreign Service, and the intelligence community are excluded if they are on extended tours of duty located more than 50 miles from the home.
- Periods of temporary absence due to illness, employment, or unforeseen circumstances of up to two years are also excluded from nonqualifying use.

Example 11. Bert, a single individual, buys a principal residence on January 1, 2009, for $400,000 and moves out on January 1, 2019. Bert sells the property on December 1, 2021, for $600,000. The entire $200,000 gain is excluded from his gross income under IRC §121 as under present law. Periods after the last qualified use do not constitute nonqualified use.[52]

50. The example is taken from the Joint Committee on Taxation, Technical Explanation of the HATA.

51. IRC §121(b)(4)

52. Ibid

Example 12. Andy and Ellie, a married couple, jointly bought a vacation home (not a principal residence) on January 1, 1994 and used it as a vacation home for several weeks per year through December 31, 2010 (a full 17-year period). Following their retirement, they move into their former vacation home on January 1, 2011. They use it as their principal residence for two years (January 1, 2011 through December 31, 2013) and sell it on January 1, 2014. Their gain on the sale is $300,000 (no depreciation was claimed on the property because it was never rented).

Andy and Ellie owned the property for 20 years. During the period of time after December 31, 2008 (new law applies), they used the property for "nonqualified use" for two years when they used it as a vacation home during January 1, 2009 through December 31, 2010. Therefore, only 10% of their gain is taxable as shown below:

Total time the property was owned (January 2, 1994 through January 1, 2014)	20 years
Period of "nonqualified use" after December 31, 2008	2 years
Taxable percentage	10%
Taxable portion of 2014 long-term gain ($300,000 × 10%)	$ 30,000
Portion of gain excludible under IRC §121 (<$500,000)	$270,000

Note. If the couple had converted their vacation home to their principal residence prior to January 1, 2009, none of their 2014 long-term $300,000 gain would be taxable. **Per the transition rules, the new law only applies to sales after December 31, 2008 based on periods of "nonqualified use" that begin on or after January 1, 2009.**

HURRICANE CASUALTY LOSS ELECTION

Many taxpayers claimed casualty loss deductions due to hurricanes Katrina, Rita, and Wilma. If the taxpayer claimed a deduction due to damage to his principal residence and later received a reimbursement for the loss, he may elect to file an amended return for the year in which the deduction was taken. The amended return must be filed by the later of:

- Three years after the due date of the original return, or
- Four months after July 30, 2008.

The taxpayer will owe one year of interest on any underpayment of tax, but will not be assessed any additional penalty or interest if payment is made within one year of filing the amended return.[53]

HOUSING CREDITS

The credits due to low-income housing and rehabilitation expenditures can now offset the AMT. This provision is effective for buildings placed in service after December 31, 2007. Expenses after December 31, 2007 that qualify for the rehabilitation credit also offset AMT.[54]

Housing Credit Volume Cap

The HATA provides a temporary increase in the low-income housing credit volume limits to $2.20 per resident, up from $2 per resident. This is effective as of July 30, 2008.[55]

The annual cap for the low-income housing credit is increased for some small states by 10%.

---

53. Section 3082(b)(2) of the HATA

54. Section 3022(d)(1) of the HATA

55. Section 3001 of the HATA

Credit Percentage for Nonfederally-Subsidized Buildings

The low-income housing credit rate is temporarily increased to 9%. This applies to newly-constructed nonfederally-subsidized buildings placed in service after July 30. The Act modifies the definition of a federally-subsidized building for purposes of the credit to any obligation on which the interest is exempt from tax under IRC §103.[56]

Difficult Development Areas

The areas eligible for the enhanced credit are expanded. They now include any building designated by the state housing credit agency as requiring the enhanced credit so the building will be financially feasible. This applies to buildings placed in service after July 30, 2008.[57]

Definition of Substantial Rehabilitation Expenditures

The rehabilitation expenditures required to qualify as a separate building for the low-income housing credit are increased. They are increased to the greater of:

1. At least 20% of the adjusted basis of the building, or
2. At least $6,000 per low-income unit in the building.[58]

These amounts will be adjusted for inflation beginning in 2010. The new amounts are effective for housing credits after July 30, 2008.

Community Service Facilities

The Act also increases the number of community service facilities eligible for the credit. The size of the facility may not exceed the sum of:

1. 25% of the eligible basis, not exceeding $15 million, and
2. 10% of any excess over $15 million.

This applies to buildings placed in service after July 30, 2008.[59]

Military Personnel Housing

The "basic housing allowance" provided to military members is no longer included in income when determining low-income for purposes of the income eligibility rule. This benefits the building owners that rent to military members. Qualifying buildings must be located:

- In a country that contains a qualified military installation that has at least 1,000 armed forces members, and has increased the number of military members by at least 20% between December 31, 2005, and June 1, 2008; or
- In a country adjacent to the country described above.

This provision is in effect for income determinations made after July 30, 2008, and before January 1, 2012.[60]

Other Changes

There are several additional changes made in the low-income housing credit area. For additional information, see the details provided in the HATA.

There are also numerous changes relating to real estate investment trusts (REIT). For additional information, see the details provided in the HATA.

---

56. Section 3002(c) of the HATA
57. Section 3003(h)(1) of the HATA
58. Section 3003(h)(2)(B) of the HATA
59. Section 3003(h)(1) of the HATA
60. Section 3009(b) of the HATA

ACCELERATED CREDIT ELECTION

Corporations may now elect to claim an accelerated credit for a portion of the unused research credits and AMT credit earned in tax years prior to January 1, 2006. However, they must forgo claiming the 50% bonus depreciation. Because the accelerated credit is refundable, a corporation may receive a payment for the credit even if there is no tax liability for the year in which the credit is claimed. Eligibility for the election requires a qualified property to be acquired after March 31, 2008, and be otherwise eligible for bonus depreciation. The credit refund is limited to the bonus depreciation amount computed for the tax year.[61]

CORPORATION ESTIMATED PAYMENTS

The Tax Increase Prevention Act of 2005 made changes to the large-corporation estimated tax payments effective for July, August, and September of 2012. The HATA changed the 2012 date to 2013.[62]

NEW REPORTING REQUIREMENTS

For years beginning after December 31, 2010, credit card companies and companies such as PayPal are required to make annual reports of transactions to the IRS and the participating payee businesses. This includes credit- and debit-card transactions, third-party network transactions, and transactions involving certain intermediaries. A report is required if the third-party network transactions of any participating payee exceed $20,000 and the aggregate of such transactions exceeds 200. Payees subject to the reporting requirement are also subject to backup withholding requirements.[63]

Failure to file the required reports is subject to the normal Form 1099 penalties.

EXPIRED PROVISIONS

At the time this workbook was printed, the following tax provisions for individuals have not been extended:

- Enhanced AMT exemption amounts
- Allowance for certain personal tax credits against the AMT
- Deduction for educator expenses in calculating AGI
- Tuition and fees deduction
- Deduction for state and local sales taxes
- Nonbusiness energy property credits
- The increased AGI limits for a deduction for a qualified conservation contribution
- The exception to the early-withdrawal penalty for plan distributions to reservists and repayments made to an IRA for individuals called to active duty in 2007
- The exclusion from income for certain IRA distributions made directly to a charity

61. Section 3081(d) of the HATA
62. Section 3094(a) of the HATA
63. Section 3091(e) of the HATA

In addition, the following business provisions have not been extended:

- Research credit (for amounts paid or incurred after 2007)
- Shareholder basis adjustment for stock of S corporations making charitable contributions (for tax years beginning after 2007)
- Indian employment credit (for tax years beginning after 2007)
- Accelerated depreciation for qualified Indian reservation property placed in service in 2007
- 15-year recovery period for qualified leasehold improvements and restaurant property placed in service after 2007
- 7-year recovery property for a qualified motorsports entertainment complex (for property placed in service after 2007)
- Special rules for contributions of food and book inventories (for contributions made after 2007)
- Special rule for corporate contributions of computer technology or equipment for educational purposes (for tax years beginning after 2007)
- Tax incentives based on the District of Columbia Enterprise Zone (for any period after 2007)
- Deduction for domestic production activities in Puerto Rico (for tax years beginning after 2007)
- Suspension of 100% taxable-income limit on percentage depletion for oil and natural gas from marginal properties (for years beginning after 2007)
- Environmental cleanup (remediation) costs deduction (for costs paid or incurred after 2007)
- Reforestation expense deduction increase for certain small timber producers (for expenses paid or incurred after 2007)