RECAP OF SIGNIFICANT DEVELOPMENTS IN THE FIRST QUARTER 2008

While the Economic Stimulus Act of 2008 was the most significant development in the first quarter of 2008, many other tax developments may affect you, your family and your livelihood. The new law changes and other key developments are summarized below. Please call us for more information about any of these developments and what steps should be implemented to take advantage of favorable developments and to minimize the impact of those which are unfavorable.

- **Economic Stimulus Act.**

  On February 13, 2008, President Bush signed the "Economic Stimulus Act of 2008" (Stimulus Act) into law. The centerpiece of the Stimulus Act, which was designed to bolster the sagging economy, was a provision that put extra cash into the hands of most Americans. Most will receive a rebate check in 2008 from the IRS based on the filing status and income stated on their 2007 return (which is filed in 2008). Some will get a tax credit in 2009 when they file their returns for tax year 2008, and still others (depending largely on income in tax years 2007 and 2008) may receive a combination of a rebate check in 2008 and an income tax credit in 2009. To receive the cash rebate, taxpayers, including many who wouldn't ordinarily have to file a return, *must* file a return for tax year 2007. Key provisions in the Stimulus Act include:

  - Most taxpayers are to receive cash rebate payments, which typically will equal the amount of tax liability on the 2007 return, up to a maximum amount of $600 for individuals ($1,200 for taxpayers who file a joint return) and a minimum of $300 for individuals ($600 for taxpayers who file a joint return). There is also an additional $300 for each qualifying child. The rebates are reduced by 5% of adjusted gross income (AGI) in excess of $75,000 for individuals and $150,000 for those who are married and file jointly. Those individuals who have little or no tax liability may also qualify for a minimum payment of $300 ($600 if filing a joint return) if they file a tax return which reflects $3,000 or more in qualifying income (which includes Social Security benefits, railroad retirement benefits and certain disability or survivors' benefits from the Veterans Administration).

  - Expensing - the option to currently deduct the cost of business machinery and equipment - is made much more attractive for tax years beginning in 2008. The amount a taxpayer could otherwise expense, $128,000, has been increased to $250,000 for tax years beginning in 2008. And, the $510,000 overall investment limit (beyond which there's a phase-out of current expensing) has been increased to $800,000 for tax years beginning in 2008.

  - In addition to the usual depreciation allowed for business property, taxpayers may take an extra "bonus" depreciation deduction for the first year certain property is placed in service. A bonus first-year depreciation deduction of 50% of adjusted basis is allowed for qualified property (most new personal property and software) acquired and placed in service after December 31, 2007, and before January 1, 2009. (The liberalized rules for writing off business autos are covered below.)

- **Zero Tax on Long-term Capital Gain and Dividend Income.**

  Beginning this year and continuing through 2010, a zero tax rate applies to most long-term capital gain and dividend income which would otherwise be taxed at the regular 15% rate and/or the regular 10% rate (last year, a 5% rate applied to such income). This low rate has an impact not only on lower-bracket individuals but also, surprisingly, on some whose top dollars are taxed well in excess of 15%. The amount of income taxed at 0% depends on the interplay between an individual's filing status, his taxable income and how much of that taxable income consists of long-term capital gain and qualifying dividend income.

- **$1 Million Deduction Limit.**

  Generally, a publicly held corporation's deduction for compensation paid during a tax year to its chief executive officer or any of its three highest paid officers is limited to $1 million. The IRS has formally ruled compensation paid to an executive is not excepted from this limit as qualified performance-based compensation if the plan or contract under which it's paid also provides for payment to the executive on: (1) termination without cause or for the executive's resignation for good reason or (2) voluntary retirement. In a concession to taxpayers, the IRS will only apply this new interpretation of the rules prospectively.

- **Quicker Deduction for Payroll Tax on Bonuses and Vacation Pay.**

  The IRS has allowed employers who use the accrual method of accounting and incur payroll taxes (Federal Insurance Contributions Act (FICA) tax and Federal Unemployment Tax Act (FUTA) tax) to take a deduction for bonuses and vacation pay in an earlier year than the year in which the amounts are paid in many cases. The IRS now allows these employers to use the recurring item accounting exception. In general, under this exception, taxpayers may be able to currently deduct certain recurring liabilities that they pay on or before the earlier of when they must file their returns (including extensions), or the 15th day of the ninth calendar month after the close of the tax year.

- **Lifetime Pay-outs to Non-spouse IRA Beneficiary.**

  In a private letter ruling, the IRS has allowed a non-spouse beneficiary of an individual retirement account (IRA) to salvage lifetime pay-outs even though she failed an essential rule requiring distributions to begin by the end of the year following that of the IRA owner's death. Generally, where an IRA owner dies before he must start taking annual required minimum distributions, the IRA must be distributed to a non-spouse beneficiary either within five years of his death, or over the life or life expectancy of the designated beneficiary. To qualify for the latter alternative, the distributions must begin no later than one year after the deceased owner's death. However, the IRS allowed the beneficiary, who made up her missed annual required minimum distributions and paid a penalty excise tax, to avoid the tough five-year payout rule. This was an extremely favorable result for the taxpayer, allowing her to avoid quickly depleting the IRA (and by so doing, having to likely pay more taxes, sooner). The ruling illustrates the hazards of not receiving expert tax advice when dealing with post-death IRA distributions.

- **Trust's Investment Advice Fees.**

  The Supreme Court has held investment advisory fees paid by a trust were deductible only to the extent that they exceeded 2% of the trust's adjusted gross income (AGI). Thus, such expenses didn't qualify for the exception to the 2% of AGI limit in the tax law for costs paid or incurred in connection with the administration of a trust or estate which wouldn't have been incurred if the property weren't held in the trust or estate. However, for the sake of administrative convenience, the IRS has provided for tax years beginning before January 1, 2008, non-grantor trusts and estates will not have to "unbundle" a fiduciary fee (i.e., separate the fee into components which are subject to the deduction limit and those aren't). As a result, for 2007 tax years, affected taxpayers can deduct the full amount of a bundled fiduciary fee without regard to the 2% floor.

- **Luxury Auto Depreciation Limits for 2008.**

  Under special "luxury automobile" rules, a taxpayer's otherwise available depreciation deduction for business autos, light trucks and minivans is subject to additional limits, which operate to extend depreciation beyond its regular period. The IRS has released the inflation-adjusted depreciation limits for business autos, light trucks and vans (including minivans) placed in service in 2008 - e.g., the first-year depreciation limit is $2,960 for autos and $3,160 for light trucks or vans first placed in service in 2008. The "luxury passenger auto limits" cap the otherwise allowable depreciation which can be claimed in a year. Generally, the maximum annual depreciation deduction limits for these vehicles are close to what they were for vehicles that were placed in service last year: the dollar limits for the first and second years for business autos, light trucks and vans are $100 lower than last year's figures. However, for vehicles which qualify, the Economic Stimulus Act of 2008 increases the otherwise applicable first-year limit by $8,000 - e.g., $10,960 for autos and $11,160 for light trucks or vans first placed in service in 2008.

- **Chances of Being Audited.**

  The IRS has issued its annual data book, which provides statistical data on its fiscal year 2007 activities, including how many tax returns it examines (audits), and what categories of returns it focuses its resources on. Out of a total of 135 million individual returns filed in calendar year 2006, about 1,384,563 individual income tax returns (1.0%) were audited during fiscal year 2007, slightly more than those examined in the prior year. Of the 1.5 million individual farm returns which showed gross receipts from farming (Schedule F), only 5,705 (0.4%) were audited in 2007. For returns with total positive income of at least $200,000 and under $1 million, the audit rate was 2% for nonbusiness returns and 2.9% for business returns; for returns of $1 million or more, the audit rate was 9.3%. The audit rate for corporations with less than $10 million of assets was 0.9% (up from 0.8% in the prior year); and for corporations with $10 million or more of assets, it was 16.8% (down from 18.6%). The audit rate for S corporations was 0.5% (up from 0.38% for the prior year); and for partnerships it was 0.4% (up from 0.36%).

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