

RECAP OF SIGNIFICANT DEVELOPMENTS IN THE SECOND QUARTER 2008

There were a number of important tax developments in the second quarter of 2008 effecting individuals. While the Farm and Military Acts were the most significant developments in the second 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 you should implement to take advantage of favorable developments and to minimize the impact of those that are unfavorable.

■ **Farm Act.**

Briefly stated, the Farm Act, which became law during the second quarter of 2008, includes these key tax changes. Many of the changes have complex effective dates.

- Thanks to a key change, there is no self-employment tax on conservation reserve payments (government payments for conserving and improving soil, water and wildlife resources) received by an individual who is getting Social Security retirement or disability payments.
- The favorable tax treatment for qualified conservation contributions (certain transfers of qualified real property interests to qualified organizations exclusively for conservation purposes) is extended through 2009.
- There's a new deduction for farmers' endangered species recovery expenses.
- There's a one-year cut in the tax rate for a corporation's qualified timber gain.
- There's a new credit for cellulosic biofuels, plus a new credit for agricultural chemicals security expenses.
- All racehorses placed in service after 2008 and before 2014 are classified as three-year property for depreciation purposes, regardless of their age.
- Victims of the 2007 Kansas tornado disaster get a host of tax breaks similar to the tax breaks created for the victims of the 2005 Gulf area hurricanes.
- There's a new limitation on the amount of farming losses that non-C corporation taxpayers may deduct currently.
- Changes to the farm optional method and non-farm optional method for computing net earnings from self-employment for post-2007 tax years allow electing taxpayers to pay more in optional self-employment taxes to gain more Social Security benefits.

- The Commodity Credit Corporation (CCC) is required to report the amount of market gain a farmer realizes when he or she repays a CCC market assistance loan.

■ **Military Act.**

In a nutshell, the Military Act, which also became law during the last quarter, includes these key changes. Many of the changes also have complex effective dates.

- Rebate checks under the Stimulus Act go to those in the active military who file jointly even if one spouse does not have a Social Security number.
- The earned income credit for combat pay is revived and made permanent.
- The rule allowing reservists who are called up to make penalty-free premature withdrawals from company retirement plans or IRAs has been made permanent.
- Special bond rules to help qualified veterans obtain mortgage financing are permanently extended.
- Survivors of military personnel may gain additional retirement benefits under revised rules.
- The tax treatment for recipients of differential pay (an employer's voluntary payment of compensation which service members would otherwise been paid during active duty) is revised, and a new tax credit is created for small employers who pay it.
- The deadline for filing tax refund credit claims arising from Department of Veterans Affairs disability determinations has been extended.
- The rule allowing active duty reservists to make penalty-free withdrawals from retirement plans has been made permanent.
- A new rule allows a military death gratuity or amount received under the Service Members' Group Life Insurance (SGLI) program to be rolled over to a Roth IRA or Coverdell education savings account.
- The home sale exclusion rules have been liberalized for Peace Corps volunteers and employees of the intelligence community.
- Members of the reserves who are called to active duty may withdraw unused amounts held in a health flexible spending account (health FSA).
- The tax rules for those who expatriate have been toughened significantly.

■ **Genetic Discrimination.**

A new law has been enacted to bar discrimination in health insurance and employment on the basis of an individual's genetic information, beginning in May 2009.

■ **Stimulus Payments.**

Based on an individual's direct deposit designation on his or her 2007 return, the special economic stimulus payment may have been direct deposited by the IRS into a tax-favored account, such as an IRA, a health savings account (HSA), an Archer medical savings account (MSA), a Coverdell education savings account (CESA) or a qualified tuition program account (QTP or Code Sec. 529 program). A taxpayer who took advantage of this feature may discover he or she needs the stimulus payment in cash. The IRS has advised taxpayers they may withdraw from a tax-favored account an amount not exceeding the amount of the economic stimulus payment directly deposited into that account, notwithstanding any tax law restrictions. If withdrawals are made no later than the time for filing the taxpayer's income tax return for 2008, plus extensions (or in the case of a CESA, the later of May 31, 2009, or the time for filing the taxpayer's income tax return for 2008, plus extensions), the amount withdrawn will be treated as neither contributed to nor distributed from the tax-favored account. Thus, the withdrawal won't be subject to regular federal income tax or to any additional tax or penalty tax.

■ **Boosted Standard Mileage Rate for Second Half of 2008.**

The standard mileage allowance for owned or leased autos (including vans, pickups or panel trucks) has been increased 8¢ from 50.5¢ to 58.5¢ per business mile for travel from July 1, 2008, to December 31, 2008, to better reflect the real cost of operating an auto in this period of rapidly rising gas prices. The rate can also be used by employers to reimburse tax-free under an accountable plan employees who supply their own autos for business use. Additionally, an employee's personal use of lower-priced company vehicles during 2008 may be valued at 58.5¢ per mile if certain conditions are met. The rate for using a car to get medical care or in connection with a move which qualifies for the moving expense has also increased 8¢ for the last half of 2008 from 19¢ to 27¢ per mile.

■ **Health Savings Accounts (HSAs).**

There have been several important developments relating to HSAs:

- (1) The IRS issued final regulations providing guidance on miscellaneous HSA comparability requirements. HSAs aren't subject to nondiscrimination rules restricting the amount of benefits provided to highly compensated employees. Instead, if an employer decides to fund HSAs, it must make "comparable" contributions to all comparable participating employees' HSAs. The guidance addresses situations where an employee has not established an HSA by December 31st of a year and where an employer accelerates contributions for the calendar year for employees who have incurred qualified medical expenses.
- (2) The IRS released the annual inflation-adjusted contribution, deductible, and out-of-pocket expense limits for 2009.
- (3) The IRS issued detailed guidance on changes to the HSA rules made by the Tax Relief and Health Care Act of 2006. For example, the guidance explains the maximum annual contribution to an HSA is the sum of the contribution limits determined separately for each month, based on eligibility and health plan

- coverage on the first day of the month. Under the “full contribution” rule, a taxpayer who is an eligible individual during the last month of a tax year is treated as having been an eligible individual during every month during the tax year for purposes of computing the annual HSA contribution. The guidance explains the full contribution rule can increase, but not decrease, the contribution limit for an individual.
- (4) The IRS provided guidance on a qualified HSA funding distribution from an individual's Individual Retirement Account (IRA) or Roth IRA to a Health Savings Account (HSA). Enacted as part of the Tax Relief and Health Care Act of 2006, the qualified HSA funding distribution is a one-time transfer from an individual's IRA to his or her HSA. It is generally excluded from gross income and not subject to the 10% early withdrawal penalty.

■ **Mortgage Debt Forgiveness.**

The IRS released an updated version of IRS Publication 4681, Canceled Debts, Foreclosures, Repossessions and Abandonments. It explains the rules which currently apply for canceled debt on a principal residence. In general, a taxpayer realizes income when debt is forgiven. There are several exceptions and exclusions which may result in all or part of a taxpayer's income from the cancellation of debt being nontaxable. For example, the Mortgage Relief Act, effective for indebtedness discharged on or after January 1, 2007, and before January 1, 2010, generally allows taxpayers to exclude up to \$2 million of mortgage debt forgiveness on their principal residence. The exclusion is claimed by filling out Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), and attaching it to the taxpayer's applicable income tax return. The new IRS publication also explains the tax treatment of foreclosures and abandonments of residences.

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