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Baker Hostetler
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EXECUTIVE ALERT

October 3, 2008

Revised Bailout Plan with New Tax Provisions Passes Congress

After a number of false starts and significant market turmoil, Congress has revised and passed the Emergency Economic Stabilization Act of 2008 (the "Bailout Plan"), which provides graduated authority to the Secretary of the Treasury to purchase up to \$700 billion of mortgage-backed securities and other troubled assets from U.S. financial institutions to help restore liquidity to the U.S. financial system. The \$700 billion is being made available to Treasury in tranches, with \$250 billion immediately available; an additional \$100 billion available upon report to Congress, certified by the President; and the remaining \$350 billion available provided the President provides Congress with a written report detailing the Secretary's plan for the final tranche and Congress does not pass a joint resolution of disapproval.

The Bailout Plan also allows Treasury to establish an insurance program to guarantee troubled assets and contemplates that private institutions would have opportunities to work with or for the Treasury to purchase and manage assets.

The Bailout Plan increases Federal Deposit Insurance Corporation limits from \$100,000 to \$250,000 until December 31, 2009, bolsters the SEC's ability to soften mark-to-market accounting rules, provides AMT relief, extends certain expiring tax provisions, revises tax return preparer penalty standards, provides incentives for energy production and conservation, provides certain individual income tax relief and contains mental health parity provisions applicable to insurance coverage. The Bailout Plan also contains a number of revenue raisers.

Companies with an interest in the legislation should contact federal agency officials immediately; rules and regulations to implement the broad and somewhat vague legislative language will be drafted beginning this week.

Complete Regulatory Reform of the U.S. Financial System

The Bailout Plan contemplates a comprehensive reform of the United States' financial system and establishes an oversight panel within the legislative branch comprised of five members appointed by the majority and minority leaders. That Oversight Panel is required to study financial system regulation and submit to Congress, not later than January 20, 2009, a special report containing regulatory reform proposals, including proposals the Oversight Panel believes necessary to begin regulating financial market participants not currently subject to regulation.

For additional information about the Bailout Plan, please contact your Baker Hostetler attorney or one of the following members of our Financial Services Team:

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Our Financial Services Team includes Mike Oxley, former Chairman of the House Financial Services Committee, as well as former Treasury officials, former SEC enforcement officials, former Hill staff, and former Department of Justice enforcement officials. Our Team members are in regular contact with top government policy-makers and enforcement officials, and represent numerous financial services sector clients with respect to lobbying, government enforcement issues, bankruptcies and restructurings, and a multitude of issues relating to the economic crisis and proposed reforms.

Troubled Asset Relief Program ("TARP")

The Bailout Plan creates a new Treasury Office of Financial Stability, with its own Treasury Assistant Secretary within Treasury's Office of Domestic Finance, and directs Treasury to establish a troubled asset relief program ("TARP") to purchase up to \$700 billion of troubled assets from financial institutions through December 31, 2009 (with an extension available through 2010 upon certification of need to Congress). Financial institutions participating in TARP are required by the Bailout Plan to provide the United States Treasury with non-voting common or preferred stock warrants (Treasury also may accept voting stock, provided it agrees not to exercise voting rights), or, in the case of non-registered institutions, senior debt. If a publicly traded or listed institution becomes non-listed, the Bailout Plan requires the warrant by its terms to convert to senior debt or otherwise ensure Treasury is appropriately compensated for the value of the warrant. The Bailout Plan requires the terms of these instruments to be designed to cover losses and administrative costs and to allow taxpayers to share in equity appreciation.

The Bailout Plan contemplates that Treasury will purchase troubled assets using market mechanisms, including reverse auctions. In a reverse auction, the roles of the buyer and seller are reversed. Banks desiring to sell nonperforming assets submit quotes containing prices at which they are willing to sell. The government then evaluates the assets and offers, and purchases assets from those banks who agree to sell on terms most favorable to Treasury. The Bailout Plan contemplates that Treasury would either hold assets it purchases to maturity or sell them at an appropriate time. Cash received from liquidating assets or from interest payments would be returned to Treasury for the benefit of taxpayers.

The Secretary is authorized to designate financial institutions as financial agents of the government and to establish vehicles to purchase, manage, and sell troubled assets. In addition, the Secretary is permitted to choose the FDIC as an asset manager and may waive provisions of the Federal Acquisition Regulations. The Secretary also is required to issue regulations or guidelines to prohibit conflicts of interest in the administration of the program and guidance concerning criteria for identifying troubled assets for purchase, mechanisms for purchasing assets, methods for pricing and valuing assets, and procedures for selecting asset managers. The Bailout Plan establishes a Financial Stability Oversight Board, whose function is to review the exercise of authority, to make recommendations regarding its use, and to report any suspected fraud or misrepresentation to the Special Inspector General for TARP or the Attorney General.

In conjunction with TARP, Treasury is required to establish a program to guarantee or otherwise insure troubled assets of financial institutions. Upon request of a financial institution, Treasury may guarantee the timely payment of both principal and interest relating to troubled assets. Treasury is required to establish risk-based premiums for its guarantees sufficient to meet anticipated claims. The Bailout Plan generally requires Treasury to encourage the private sector to both participate in the purchase of troubled assets and to invest in financial institutions.

Assistance for Homeowners

The Bailout Plan requires Treasury to modify troubled loans it controls and to direct other federal agencies to modify loans they own or control to help minimize foreclosures. The Bailout Plan also extends current tax law forgiveness on the cancellation of mortgage indebtedness to the end of 2012.

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Tax Provisions Related to Bailout Policies

Tax Relief for Banks that Held Fannie Mae or Freddie Mac Stock

The Bailout Plan would allow most banks that held Fannie Mae or Freddie Mac preferred stock on September 6, 2008, or that sold such stock on or after January 1, 2008, and before September 7, 2008, to recognize an ordinary rather than a capital tax loss as a result of such a disposition.

Restrictions on Executive Compensation and Severance Pay

The Bailout Plan modifies sections 162(m) (which limits the deductibility of compensation paid to senior public company executives) and 280G of the Internal Revenue Code (which penalizes so-called "excess parachute payments" made in connection with a change of control) and requires Treasury to promulgate rules to apply these new modifications to financial institutions participating in TARP. The section 162(m) modification, at minimum, would cut in half the present executive compensation limitation from \$1 million to \$500,000 when triggered. The modification to the parachute payment rules found in section 280G expands its application when applied to TARP participants and their specified executives to additional severance circumstances beyond a change of control, and prohibits so-called "golden parachute" payments for newly hired senior executives during implementation of any Bailout Plan. How and whether the rules would apply to what traditionally is considered performance-based compensation is unclear.

In addition to the provisions described above, the Bailout Plan includes changes to the tax return preparer penalty standards, energy incentives, AMT relief and tax extenders, mental health parity provisions, provisions relating to rural schools, and disaster relief provisions.

Changes To Tax Return Preparer Penalty Standards -- Finally!!

The Bailout Plan modifies the section 6694 standards for imposing penalties on tax return preparers for understatements of tax to require: (1) substantial authority for a position with respect to an item on a tax return if such position is not specially disclosed with the return; (2) a reasonable basis for a position specially disclosed with the return, and (3) a reasonable belief that a position with respect to a tax shelter or a reportable transaction will more likely than not be sustained on its merits (regardless of any special disclosure). The provision also provides a reasonable cause exception to the preparer penalty.

Revenue Raisers, Including a Deferred Compensation Provision

The Bailout Bill includes a number of revenue provisions, including provisions to (i) freeze the section 199 deduction at 6 percent for gross receipts derived from the sale or exchange of oil and natural gas; (ii) eliminate the different treatment of foreign oil and gas extraction income and foreign oil related income for purposes of the foreign tax credit; (iii) require mandatory basis reporting by brokers for transactions involving publicly traded securities; (iv) provide for a .2 percent FUTA surtax; (v) increase and extend the oil spill tax; and (vi) require current income inclusion (once there is no substantial risk of forfeiture) for individuals in receipt of deferred compensation from certain tax indifferent parties (such as an offshore corporation in a low or no-tax jurisdiction that may not be adverse to the executive regarding matching of employer deductions with employee income inclusions).

Energy Incentives

The energy incentives in the Bailout Plan include energy tax credits and incentives to encourage wind and refined coal production, new biomass facilities, wave and tide electricity generators, solar energy property improvements, carbon dioxide capturing, plug-in electric drive vehicles, idling reduction units on truck engines, cellulosic biofuels, ethanol production, energy efficient houses, offices, dishwashers, clothes washers and refrigerators, and fringe benefits for employees commuting by bicycle.

Renewable Energy Incentives

Specifically, the Bailout Plan extends and modifies the production tax credit by (i) extending through 2009 the placed-in-service date for the tax credit for producing electricity from qualified wind and refined coal facilities; (ii) extending through 2011 the placed-in-service date for the tax credits for producing electricity from closed and open-loop biomass, geothermal or solar energy, small irrigation power, municipal solid waste, trash combustion, and qualified hydropower; (iii) updating the definitions of and rules for "open-loop biomass facilities," "closed-loop biomass facilities," "trash combustion facility," and "nonhydroelectric dam" for purposes of such credit; (iv) including marine and hydrokinetic renewable energy (e.g., waves and tides) as a renewable resource for purposes of the tax credit; and (v) increasing emissions standards for refined coal and modifying its definition to require that it either meet the market value test or be considered steel industry fuel as defined.

The Bailout Plan extends and modifies the energy credit by (i) extending through 2016 the 30 percent investment tax credit for solar energy property and qualified fuel cell property, and the 10 percent investment tax credit for microturbine property; (ii) providing for a new 10 percent investment tax credit for combined heat and power system property and geothermal heat pumps; (iii) increasing to \$1,500 the credit limitation for qualified fuel cell property; (iv) allowing public utility property to be treated as energy property and qualify for the energy credit; and (v) adding "qualified small wind energy property" as a category eligible for the 30 percent investment tax credit (up to \$4,000). The Bailout Plan allows this investment tax credit (also called energy credit) to be used to offset alternative minimum tax (AMT) liabilities.

The Bailout Plan extends and modifies the residential energy-efficient property credit by (i) extending through 2016 the credit for qualified solar or fuel cell property expenditures; (ii) removing the credit cap of \$2,000 for solar electric property; (iii) adding residential wind property, capped at \$4,000 as a category eligible for the credit; and (iv) adding geothermal heat pumps, capped at \$2,000 as a category eligible for the credit. The Bailout Plan allows this credit to be used to offset alternative minimum tax (AMT) liabilities.

The Bailout Plan authorizes \$800 million of new clean renewable energy bonds ("CREBs") to finance facilities that generate electricity from wind, closed-loop biomass, open-loop biomass, geothermal, small irrigation, qualified hydropower, landfill gas, marine renewable and trash combustion facilities. The authorization is subdivided into thirds: 1/3 for qualifying projects of State/local/tribal governments; 1/3 for qualifying projects of public power providers; and 1/3 for qualifying projects of electric cooperatives. The Bailout Plan also extends the termination date for existing CREBs by one year.

The Bailout Plan extends the present-law deferral of gain on sales of transmission property by vertically integrated electric utilities to FERC-approved independent transmission companies.

Carbon Mitigation and Coal

The Bailout Plan provides the following carbon mitigation provisions: (i) increases to 30 percent the investment tax credit rate for power generation projects using integrated gasification combined cycle and other advanced coal-based generation technology projects; (ii) increases the maximum credit amounts allocable for such projects to \$2.55 billion; (iii) increases to 30 percent the investment tax credit rate for coal gasification projects; (iv) increases by \$250 million the aggregate credit amounts for coal gasification projects; (v) extends the excise tax on coal until the earlier of December 31, 2018, or the day after the first December 31st after December 31, 2007, on which there is no balance of repayable advances made to the Black Lung Disability Trust Fund and no unpaid interest on such advances; (vi) sets forth a special rule for refund claims of coal excise tax by certain coal producers and exporters; (vii) provides a tax credit for carbon dioxide sequestration; (viii) provides that certain income and gains relating to industrial source carbon dioxide be treated as qualifying income for publicly traded partnerships; (ix) directs the Secretary of the Treasury to contract with the National Academy of Sciences for a comprehensive review of Internal Revenue Code provisions that have the largest effects on carbon and other greenhouse gas emissions; and (x) requires the Academy to report to Congress on the results of such study not later than two years after the enactment of this Act.

Transportation and Domestic Fuel Security

The Bailout Plan provides the following transportation and domestic fuel security provisions: (i) includes cellulosic biofuel within the definition of biomass ethanol plant property for purposes of bonus depreciation; (ii) extends through 2009 income and excise tax credits (and increases the rates of such credits) for biodiesel and renewable diesel used as fuel; (iii) disqualifies foreign-produced fuel that is used or sold for use outside the United States for the income and excise tax credits for alcohol, biodiesel, and alternative fuel production; (iv) extends the alternative fuel excise tax credit under section 6426 through December 31, 2009 for all alternative fuels, including biomass gas versions of liquefied petroleum gas and liquefied or compressed natural gas, and aviation fuels; (v) requires that beginning 10/1/09, qualified fuel derived from coal through the Fischer-Tropsch process must be produced at a facility that separates and sequesters at least 50 percent of its carbon dioxide emissions and 75 percent of its carbon dioxide emissions starting 12/31/09; (vi) allows a new tax credit for the production of qualified plug-in electric drive motor vehicles; (vii) allows an exclusion from the heavy truck excise tax for idling reduction devices and advanced insulation used in certain heavy trucks and trailers; (viii) extends the 30 percent credit for alternative refueling property, through 2010; (ix) allows publicly traded partnerships to treat income derived from the transportation or storage of certain alternative fuels and industrial source carbon dioxide as qualifying income for purposes of the publicly traded partnership rules; (x) extends and modifies the election to expense certain refineries by extending the refinery expensing contract requirement and the placed-in-service requirement for two years and including refineries directly processing shale or tar sands for this provision; (xi) extends for 2009 the suspension on the taxable income limit for purposes of depreciating a marginal oil or gas well; and (xii) allows employers to provide employees who commute to work by bicycle limited fringe benefits to offset the costs of such commuting.

Energy Conservation and Efficiency

The Bailout Plan provides the following energy conservation and efficiency provisions: (i) authorizes the issuance of qualified energy conservation bonds to finance local government conservation and greenhouse gas reduction projects; (ii) extends the tax credit for nonbusiness energy property expenditures through 2009, and includes energy-efficient biomass fuel stoves as a new class of energy-efficient property eligible for a consumer tax credit of \$300; (iii) clarifies the efficiency standard for water heaters; (iv) extends the tax deduction for energy efficient commercial buildings through 2013; (v) extends the new energy efficient home tax credit (\$1,000 for homes meeting 30 percent efficiency standard, \$2,000 for homes meeting 50 percent efficiency standard) through 2009; (vi) revises the amounts allowable under the tax credit for energy efficient appliances produced after 2007 (i.e., dish washers, clothes washers, and refrigerators) and extends such credit through 2010; (vii) allows an accelerated recovery period for the depreciation of qualified smart electric meters and smart electric grid systems; (viii) extends through FY2012 the authority to issue tax-exempt bonds for qualified green building and sustainable design projects; and (ix) allows taxpayers to claim accelerated depreciation for purchase of equipment used to collect, distribute or recycle a variety of commodities.

Tax Extenders

AMT Relief

The Bailout Plan provides the following AMT provisions: (i) extends the rule allowing personal credits against the AMT; (ii) increases the AMT exemption amounts to \$46,500 (individuals) and \$69,950 (married filing jointly) for 2008; (iii) increases the AMT refundable credit amount to 50 percent (to be refunded over each of two years) for individuals who have long-term unused credits from prior taxable years; and (iv) abates any underpayment of tax, interest and penalty outstanding on the date of enactment attributable to the AMT and the treatment of incentive stock options.

Extensions of Individual and RIC Withholding Tax Provisions

The Bailout Plan retroactively extends the following provisions through 2009: (i) the provision that allows taxpayers to elect to take an itemized deduction for State and local sales taxes; (ii) the provision that allows an above-the-line deduction for qualified tuition and related expenses; (iii) the provision that allows

teachers an above-the-line deduction for educational expenses; (iv) the provision that allows an additional standard deduction for real property taxes for non-itemizers; (v) the provision that permits tax-free distributions from IRAs for charitable purposes; (vi) the estate tax look-through rule for certain regulated investment company ("RIC") stock held by nonresidents; and (vii) the provision that includes a RIC within the definition of a "qualified investment entity" under section 897 of the Code. The Bailout Plan also retroactively extends section 871(k), which allows a RIC to pay qualified interest-related dividends and short-term capital gain dividends ("qualified dividends") to its non-U.S. shareholders free of withholding tax. Prior to the Act, section 871(k) only exempted qualified dividends with respect to a taxable year of a RIC beginning before January 1, 2008. Under the Act, section 871(k) is extended for two years retroactively from the January 1, 2008 expiration date. Specifically, under the Act, section 871(k) exempts qualified dividends from withholding tax so long as the qualified dividends are not with respect to taxable years of the RIC beginning after December 31, 2009.

Business Extenders

The Bailout Plan provides the following extensions through 2009: (i) the tax credit for increasing research activities (and the bill sets forth a special rule for the computation of such tax credit for taxable years in which it terminates); (ii) the new markets tax credit; (iii) the Subpart F income exception for active financing income; (iv) the look-through rule that allows deferral for certain payments between commonly controlled corporations; (v) 15-year straight-line cost recovery for qualified leasehold, restaurant, and retail improvements; (vi) the special rule for the tax treatment of certain payments to tax-exempt organizations by a controlled subsidiary; (vii) the special rule relating to reductions in the basis of S corporation stock for charitable contributions of property; (viii) the increase in limit on cover over of rum excise tax to Puerto Rico and the Virgin Islands; (ix) the economic development credit for certain domestic corporations operating in American Samoa; (x) the mine rescue team training credit; (xi) the election to expense advanced mine safety equipment; (xii) the tax deduction for income attributable to domestic production activities in Puerto Rico; (xiii) the authority for issuance of qualified zone academy bonds; (xiv) the tax credit for employers of qualified employees that work and live on or near an Indian reservation; (xv) accelerated depreciation for business property on Indian reservations; (xvi) the railroad track maintenance credit (also allowed against the AMT); (xvii) special 7-year cost recovery period for property used for land improvement and support facilities at motorsports racing track facilities; (xviii) the expensing allowance for environmental remediation costs; (xix) work opportunity tax credit for those employed within the Hurricane Katrina core disaster area; (xx) increased rehabilitation credit for structures in the Gulf Opportunity Zone; (xxi) the increased tax deduction for corporate contributions of computer equipment and technology for educational purposes; (xxii) tax incentives for business and individual residents for investment in the District of Columbia; (xxiii) the enhanced charitable deductions for contributions of food inventory; (xxiv) the enhanced charitable deductions for contributions of book inventory to schools, public libraries and literacy programs; and (xxv) the provision that reduces import duties on a limited quality of imported wool fabrics and places duties collected into the Wool Trust Fund. This last provision is extended for five years.

Tax Administration Extenders

The Bailout Plan includes a provision that permanently authorizes the IRS to return funds collected through undercover operations back into the IRS undercover program and permanently extends the IRS' authority to disclose information related to terrorist activities.

Miscellaneous

The Bailout Plan provides the following additional tax provisions: (i) lowers the earned income threshold amount for determining the refundable portion of the child tax credit; (ii) allows current deductions for up to \$15 million in film and television production costs incurred in economically depressed areas (and thereby modifies the current rule that disallows all current deductions for any film and television production that exceeds \$15 million); (iii) modifies section 199 to expand the definition of qualified film and its application to partnerships not previously covered; (iv) provides an exemption from excise tax for certain wooden arrows designed for use by children; (v) allows commercial fisherman and other individuals to income average over three years any income amounts received in connection with the Exxon Valdez litigation (and allows

them to use the funds to make contributions to retirement accounts); and (vi) provides that certain farming business machinery and equipment is treated as 5-year property.

Mental Health Parity

The Bailout Plan requires private insurance plans that offer mental health benefits to offer such benefits on par with the medical-surgical benefits. The Bailout Plan also provides that any cost-sharing or benefit limits imposed on mental health services must not be more restrictive than those imposed on medical-surgery services.

Rural Schools

The Bailout Plan reauthorizes the Secure Rural Schools program through 2011, adjusts the funding distribution formula to make it more equitable, and increases funding for the Payments in Lieu of Taxes program. The Bailout Plan also contains a provision to refund interest amounts of \$9 million relating to the payments made by Super Reachback Companies to the United Mine Workers Fund.

Disaster Relief

The Bailout Plan provides relief in the form of tax benefits for individuals and businesses in areas damaged by the storms, tornados, and flooding in the Midwest and by Hurricane Ike. Some of the relief includes: (i) qualified disaster recovery assistance distributions from IRAs; (ii) recontribution of withdrawals for home purchases; (iii) loans from qualified plans; (iv) suspension of casualty loss limitations; (v) special look-back rule for EIC and refundable child credit; (vi) additional personal exemption for housing victims; (vii) exclusion for certain cancellations of indebtedness; (viii) employee retention credit; (ix) expansion of Hope scholarship and lifetime learning credit; (x) tax-exempt bonds; (xi) additional depreciation; (xii) expensing demolition and clean-up costs; (xiii) five-year net operating loss carryback for certain amounts; (xiv) tax incentives for charitable giving; and (xv) mortgage revenue bonds.

We hope this information is helpful to you. If you have any questions, please contact your Baker Hostetler attorney or any of the contacts listed at the top of this alert.

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