(Courtesy of the Committee on Ways and Means Republicans)

Overview of Tax Provisions Contained in the "Emergency Economic Stabilization Act of 2008"

Sec. 301, Gain or Loss from Sale or Exchange of Certain Preferred Stock: Under current law, capital losses generally can only be used to offset capital gains, not to offset ordinary income. Under Sec. 301 of the bill, banks – some of which do not have sufficient capital gains against which to offset capital losses incurred as a result of holding preferred stock in Fannie Mae and Freddie Mac – would be permitted to treat certain of those capital losses as ordinary losses. Under the provision, such capital losses could be offset against ordinary income if the Fannie and Freddie preferred stock was held by banks on 9/6/08 or if the losses were incurred as a result of transactions occurring between 1/1/08 and before 9/7/08.

Sec. 302, Executive Compensation and "Golden Parachutes": Under current law (IRC Sec. 162(m)), employers are prohibited from deducting any portion of the compensation of covered employees in excess of $1 million per year. This provision only applies to publicly held corporations and only with respect to the CEO and the four other highest paid officers. The restriction does not apply to performance-based compensation, such as commissions.

For any company participating in the proposed Troubled Asset Relief Program (TARP) that sells more than $300 million of assets in the auction, Sec. 302 of the bill would impose further limitations on the deductibility of compensation paid to certain employees. Under the proposal, the $1 million deductibility cap would be reduced to $500,000. In addition, the exception for performance-based compensation would be removed, meaning any compensation above $500,000 that is paid (or earned but deferred) during a year in which the employer has cumulatively sold at least $300 million as part of the auction process, would be non-deductible. Limited exceptions would apply for qualified defined benefit or defined contribution plans. The proposal would apply to the CEO, CFO, and the three next-highest paid officers. This provision, once triggered for an employer, would continue to apply during any year in which Treasury has authority to conduct TARP auctions.

Separately, current law (IRC Sec. 280G and Sec. 4999) disallows an employer's deduction, and imposes a 20% excise tax on the employee, for the portion of a "parachute payment" to an employee resulting from a change in control of the employer (but not from other types of severance from employment) that exceeds three times the employee's base salary. The limit applies to the 250 highest paid employees, or, if less, the highest compensated one percent of employees, of the employer.

For TARP participants that sell more than $300 million of assets in the auction, Sec. 302 of the bill expands the circumstances under which a portion of a parachute payment – the portion exceeding three times an employee's base pay – would be non-deductible to the employer and subject to an excise tax on the employee. The proposal would apply to payments triggered by the departure of an employee by reason of involuntary termination, bankruptcy, liquidation, or receivership (as opposed to current law, which applies to departure upon change of control). However, the proposal would only apply to those executives covered by the general compensation limitation.

Additionally, Sec. 302 of the proposal would authorize Treasury to prescribe regulatory guidance to prevent avoidance of the rules proposed in this section and to permit flexibility in the application of these rules in the case of acquisitions, mergers, or reorganizations.

Sec. 303, Extension of Exclusion of Income from Discharge of Qualified Principal Residence Indebtedness: Under current law, a taxpayer generally has taxable income, known as "discharge of indebtedness" income, if his or her loan is forgiven or written down for an amount less than its full face value. As part of the "Mortgage Forgiveness Debt Relief Act of 2007" (P.L. 110-142), Congress enacted an exception to this general rule, permitting an income tax exclusion for discharge of indebtedness income attributable to a loan on a taxpayer's home. This exclusion applies only to loans on primary residences, is subject to a cap on the maximum amount of forgiven debt eligible for the exclusion, and does not apply to home equity lines of credit. Under the terms of P.L. 110-142, this exclusion is only available for discharges of indebtedness on home loans that occur in 2007, 2008, and 2009. Under Sec. 303 of the bill, the current-law exclusion would be extended for three years, i.e., to cover discharges that occur in 2010, 2011, and 2012.