TAX PROPOSALS IN TROUBLED ASSET RELIEF PROGRAM (TARP)

Fairness for Banks That Followed Federal Guidelines

The proposal ensures fairness for the approximate 800 banks that held Fannie and Freddie preferred stock.

Treat Losses on Freddie Mac and Fannie Mae Stock as Ordinary Losses. The proposal treats any losses on sales of Fannie Mae and Freddie Mac preferred stock by financial institutions or financial institution holding companies as ordinary losses. This would apply to any preferred stock that was owned on September 6, 2008 or sold between January 1 and Sept 6, 2008. This would allow banks to obtain the tax benefit of the loss on the preferred stock and therefore reduces the need to obtain additional capital. This should also prevent some community banks from becoming insolvent.

Preventing Government Subsidies of Excessive Compensation

Two sets of proposals to prevent the government from subsidizing excessive payments to executives under the legislation.

- For institutions that participate in the **direct purchase program**, compensation standards will be imposed by the Secretary

Direct Purchases—Where the Secretary determines that the purposes of the Act are best met through direct purchases from an individual financial institution where no bidding process or market prices are available and the Secretary receives a meaningful equity or debt position in the financial institution as a result of the transaction, the Secretary shall require that the financial institution meet appropriate standards for executive compensation and corporate governance. The standards under this section shall be effective for the duration of the holding by the Secretary of the equity position.

Criteria for Standards:

1. **General rule**: Limits on compensation to exclude incentives for executive officers to take unnecessary and excessive risks that threaten franchise value during such participation

2. **Clawback**: A provision for the recovery by the financial institution of any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains , or other criteria that are later proven to be materially inaccurate; and

3. **Golden parachute**: A prohibition on the financial institution making golden parachute payment to its senior executive officers.

- For participants in **TARP auctions** who sell $300 million in assets, or whose combined assistance from direct purchases and auctions reaches $300 million, there will be limits on golden parachutes and the tax deductibility of executive compensation

    1. **Limits on tax deductions.** Executive compensation in excess of $500,000 is not deductible, and the definition of executive compensation is expanded to include performance pay and stock options.

    2. **Golden parachutes tax penalties.** Current golden parachute tax regime expanded to apply to existing employee contracts—a 20% excise tax applies to parachute payments a (normal 3 times salary rule) triggered by termination other than by retirement of the employee, including involuntary termination of the employee, change in control or bankruptcy of the company. The employer would lose the corresponding deduction on the parachute payment.

    3. **Golden parachutes prohibition.** Golden parachutes will be prohibited prospectively for the top 5 executives in the case of termination, or in the case of bankruptcy, insolvency, or receivorship of the financial institution

Helping Homeowners

The proposal provides assistance to homeowners who have been caught up in the current mortgage crisis and are trying to save their homes.

Extend Cancellation of Mortgage Indebtedness Forgiveness. In a foreclosure proceeding or write-down of principal on a mortgage, the forgiven debt is considered taxable income. The "Mortgage Forgiveness Debt Relief Act of 2007," P.L. 110-142, excludes debt forgiven before the end of 2009 from taxable income. The proposal extends this treatment for 3 years, through 2012. It does not extend the relief to home equity loans.