

MEMORANDUM

To: Clients & Colleagues
From: Patton Boggs Financial Services & Tax Policy Group
Patton Boggs Tax and Wealth Preservation Group¹
Date: February 13, 2009
Subject: Business-Related Tax Provisions in the Stimulus Bill – the American Recovery and Reinvestment Act of 2009

I. Executive Summary

Congress is expected to pass this weekend the version of H.R. 1, the American Recovery and Reinvestment Act of 2009 (the “Act”), approved by a Senate-House Conference Committee. President Obama is expected to sign the bill soon after it is enrolled and sent to him for signature. The bill includes approximately \$287 billion of tax relief for individuals, businesses, and state and local governments.

This memorandum includes a summary of business-related tax provisions in the Act with a focus on the measures of most interest to our clients, including those dealing with business tax incentives, bond provisions and energy tax credits. A detailed discussion of the provisions affecting individual (personal) income taxes is not included here. Since many of our clients have been following the consideration of this legislation, we have noted major differences between the final legislation and the bills that the House and/or Senate initially passed.

II. General Business Tax Provisions

A. Net Operating Losses²

Under current law, net operating losses may be carried back to the two years before the year (the “loss year”) in which the loss arises (the “carryback period”) and forward to each of the twenty years after the loss year. The Act extends the carryback period for net operating losses for a taxable year ending in 2008 (or at the taxpayer’s election, a taxable year beginning in 2008) from two years to five years, but only for businesses that have \$15 million or less in gross receipts. Unlike earlier proposed

¹ This memorandum was prepared under the direction of George Schutzer with assistance from Jonathan Babu, Sean Clancy, Micah Green, Joanne Hodge, Neil Potts, Kirsten Wegner and Travis Seegmiller.

² Act § 1211.

versions of the legislation, there are no restrictions in the Act against use of the extended carryback period by a business that granted an equity interest (or a warrant to acquire an equity interest) to the U.S. Government in connection with the Troubled Asset Relief Program (“TARP”) of the Emergency Economic Stabilization Act of 2008 (“EESA”). There is also no requirement in the Act that a company electing to utilize the extended carryback period reduce the value of the relevant net operating losses by 10%.

The provisions in the Act are much more limited than the provisions in the House and Senate bills. Both bills would have extended the maximum carryback period for NOLs arising in tax years ending in 2008 and 2009 to five years for all taxpayers other than those that granted an equity interest (or a warrant to acquire an equity interest) to the U.S. Government in connection with TARP.

B. Bonus Depreciation³

In general, businesses are allowed to recover the cost of capital expenditures over time according to a depreciation schedule. Last year, Congress temporarily allowed businesses to recover the costs of capital expenditures made in 2008 faster than ordinary tax depreciation rules would allow by permitting these businesses to immediately write off 50% of the cost of depreciable property acquired in 2008 for use in the United States.

The Act extends this temporary benefit for one year, generally through 2009 (through 2010 for certain long-lived and transportation property).

The Act also extends through 2009 the temporary increase to \$250,000 of the amount of depreciable property that small and medium size businesses can expense (i.e., deduct immediately). This benefit is phased out if expenditures on depreciable property exceed \$800,000.

C. Monetization of Accumulated AMT and R&D Credits in Lieu of Bonus Depreciation⁴

The Act extends through 2009 (2010 for certain aircraft and long-production-period property) a provision included in the Housing and Economic Recovery Act that allows taxpayers to elect to forgo bonus depreciation and instead claim additional alternative minimum tax (“AMT”) and research credits that they may not otherwise be able to use because of limitations on the use of such credits.

Under this provision, the research or AMT credit limitation for electing corporate taxpayers is increased by 20% of the bonus depreciation that could otherwise be claimed. The amount is capped at the lesser of 6% of (i) outstanding and unused AMT and R&D credits and (ii) \$30 million.

³ Act §§ 1201(a) and 1202.

⁴ Act § 1201(b).

A taxpayer that made the election under the prior act for the first tax year ending after March 31, 2008, may elect to not have the election apply to extension property, i.e., property eligible for the election solely by reason of the amendments made by the Act.

D. Government Contractor Withholding⁵

For payments made after December 31, 2010, current law requires withholding at a 3% rate on certain payments made by Federal, State and local governments to contractors providing property or services to the government. The withholding is required regardless of whether the government entity making the payment is the recipient of the property or services, although those with less than \$100 million in annual expenditures for property or services are exempt. Numerous government entities and taxpayers have raised concerns about the application of this provision.

The Act delays for one year (through December 31, 2011) the application of the 3% withholding requirement on government payments for goods and services to allow the Treasury Department to study the impact of the provision on government entities and taxpayers. The Act follows the Senate version of the bill; the House version would have repealed the withholding requirement permanently.

E. Deferral of Income from Discharge of Indebtedness⁶

Under present law, a taxpayer generally recognizes income when the taxpayer cancels or repurchases a debt for an amount less than its adjusted issue price or when debt is forgiven. Various exceptions apply to the general rule. The Act allows certain businesses to elect to defer recognition of cancellation of indebtedness income (“CODI”) on the “reacquisition” of business debt instruments during 2009 or 2010. The business would defer the CODI for five years in the case of 2009 reacquisition or four years in the case of 2010 reacquisition and then recognize the CODI ratably in income over the following five years.

The new provision applies to debt instruments issued by a C corporation or by any other person in connection with the conduct of a trade or business. A debt instrument is defined as a bond, debenture, note certificate, or any other instrument or contractual arrangement constituting indebtedness.

A “reacquisition” is an acquisition of a debt instrument by the debtor that issued (or is otherwise the obligor under) the debt instrument or a related person to such debtor. The term “acquisition” includes an acquisition for cash, the exchange of the debt instrument or another debt instrument, the exchange of a debt instrument or corporate stock or a partnership interest, and the contribution of the debt instrument to capital. “Acquisition” also includes complete forgiveness of the indebtedness.

⁵ Act § 1511.

⁶ Act § 1231.

This provision contains a poison pill: If the taxpayer elects to apply the deferral provisions to an applicable debt instrument, the taxpayer may not apply any of the major exceptions to CODI for the taxable year of the election or any subsequent year. Thus, if the taxpayer elects deferral, the taxpayer may not apply the insolvency exception, the bankruptcy exception, the qualified farm indebtedness exception or qualified real property business indebtedness exception for the taxable year of the reacquisition or the following year.

Certain events, such as death, liquidation or sale of substantially all of the assets of a taxpayer, the cessation of business by the taxpayer, or a bankruptcy liquidation will result in the acceleration of the deferred income. Special rules apply to limit deductions for original issue discount on debt instruments issued in exchange for debt instrument with respect to which a deferral election is made.

F. Modification of Rules for OID on High Yield Obligations⁷

The Act suspends special rules for original issue discount (“OID”) contained in section 163(e)(5) of the Code in the case of any “applicable high yield discount obligation” (“AHYDO”) issued during the period beginning September 1, 2008 and ending on December 31, 2009 in exchange for an obligation which was not an AHYDO and the issuer of which is the same as the issuer of the AHYDO. Section 163(e)(5) ordinarily denies a deduction for a portion of the OID on an AHYDO instrument.

The Act gives the Treasury the authority beginning in 2010 to use a higher rate than prescribed by the Code for purposes of determining whether a debt instrument has a yield that will subject it to the AHYDO rules.

III. Refundable First-Time Home Buyer Credit⁸

Last year, Congress provided taxpayers with a refundable tax credit that was equivalent to an interest-free loan equal to 10 percent of the purchase of a principal residence (up to \$7,500) by first-time home buyers. The provision applies to homes purchased on or after April 9, 2008 and before July 1, 2009. Taxpayers receiving this tax credit are currently required to repay any amount received under this provision back to the government over 15 years in equal installments, or earlier under certain circumstances (for example, when the home is sold). The credit phases out for taxpayers with adjusted gross income in excess of \$75,000 (\$150,000 in the case of a joint return).

The Act eliminates the repayment obligation for taxpayers that purchase homes on or after January 1, 2009, increases the maximum value of the credit to \$8,000, allows financing of the home purchase by mortgage revenue bonds (which was prohibited under the prior credit requirements) and extends the period for which home purchases are eligible through November 30, 2009. Like the pre-Act provision, the Act permits a taxpayer to claim the credit on the taxpayer’s 2008 tax return for an

⁷ Act § 1232.

⁸ Act § 1006.

eligible purchase in 2009. The Act requires a taxpayer to pay back the amount of the credit if the house is sold within three years of purchase. The Act does not eliminate the requirement that a homebuyer must be a “first time” homebuyer to qualify for the credit.

IV. Bond Provisions

A. Recovery Zone Bonds⁹

The Act creates two new categories of bonds for investment in national recovery zones - recovery zone economic development bonds and recovery zone facility bonds.

Recovery zone economic development bonds are a new type of tax credit bond that may be issued for qualified economic development purposes, i.e., promoting development or other economic activity in a recovery zone. Recovery zone facility bonds are a new type of tax-exempt private activity bond for capital investments in national recovery zones.

The Act authorizes a \$10 billion total allocation for recovery zone economic development bonds and a \$15 billion total allocation for recovery zone facility bonds. These bonds could be issued during 2009 and 2010. Each state would receive a share of the national allocation based on that state’s job losses in 2008 as a percentage of national job losses in 2008. The State allocation would be sub-allocated to local municipalities.

B. Modification to Tax-exempt Interest Expense Rules for Financial Institutions¹⁰

Financial institutions are not allowed to take a deduction for the portion of their interest expense that is allocable to the institution’s investments in tax-exempt municipal bonds. For purposes of this interest disallowance rule, bonds that are issued by “qualified small issuers” are not taken into account as investments in tax-exempt municipal bonds. Under current law, a “qualified small issuer” is defined as any issuer that reasonably anticipates that the amount of its tax-exempt obligations (other than certain private activity bonds) will not exceed \$10 million. The Act increases this dollar threshold to \$30 million when determining whether a tax-exempt obligation issued in 2009 and 2010 qualifies for this small issuer exception. The small issuer exception would also apply to an issue if all of the ultimate borrowers in such issue would separately qualify for the exception.

Under the Act, for purposes of determining whether an issuer meets the requirements of the small issuer exception, qualified 501(c)(3) bonds issued in 2009 or 2010 are treated as if they were issued by the 501(c)(3) organization for whose benefit they were issued (and not by the actual issuer of such bonds).

⁹ Act § 1401.

¹⁰ Act § 1501 and 1502..

The Act provides a new 2% safe harbor for the interest disallowance rule for financial institutions. Under the safe harbor, tax-exempt obligations issued during 2009 and 2010 that do not exceed 2% of the adjusted basis of the financial institution's assets are not taken into account for purposes of the interest disallowance rule.

C. Qualified School Construction Bonds¹¹

The Act creates a new category of tax credit bonds for the construction, rehabilitation, or repair of public school facilities or for the acquisition of land on which a public school facility will be constructed. There is a national limitation on the amount of qualified school construction bonds that may be issued by State and local governments of \$22 billion (\$11 billion allocated initially in 2009 and the remainder in 2010).

Allocations of the national limitation of qualified school construction bonds are divided between the States and certain large school districts. The States receive 60 percent of the national limitation for a calendar year and the remaining 40 percent of the national limitation for a calendar year is allocated to certain large local educational agencies.¹²

Qualified school construction bonds must meet the following three requirements:

1. 100 percent of the available project proceeds of the bond issue is used for the construction, rehabilitation, or repair of a public school facility or for the acquisition of land on which such a bond-financed facility is to be constructed;
2. the bond is issued by a State or local government within which such school is located; and
3. the issuer designates such bonds as a qualified school construction bond.

The Act also provides a specific allocation of \$400 million for Indian school bonds (\$200 million for each of 2009 and 2010).

D. Qualified Zone Academy Bonds¹³

The Act allows an additional \$1.4 billion of Qualified Zone Academy Bonds ("QZAB") issuing authority to State and local governments in 2009 and 2010, which can be used to finance

¹¹ Act § 1521.

¹² The term large local educational agency means: any local educational agency if such agency is: (1) among the 100 local educational agencies with the largest numbers of children aged 5 through 17 from families living below the poverty level, or (2) one of not more than 25 local educational agencies (other than in 1, immediately above) that the Secretary of Education determines are in particular need of assistance, based on a low level of resources for school construction, a high level of enrollment growth, or other such factors as the Secretary of Education deems appropriate.

¹³ Act § 1522.

renovations, equipment purchases, developing course material, and training teachers and personnel at a qualified zone academy.

In general, a qualified zone academy is any public school (or academic program within a public school) below the college level that is located in an empowerment zone or enterprise community and is designed to cooperate with businesses to enhance the academic curriculum and increase graduation and employment rates. QZABs are a form of tax credit bonds which offer the holder a Federal tax credit instead of tax-free interest.

E. Industrial Development Bonds¹⁴

The Act, for purposes of industrial development bonds, expands the definition of “manufacturing facility” to include any facility used to create, produce or manufacture intangible property, including any patent, copyright, formula, process, design, knowhow, format, or other similar item. The provision would also treat any functionally related and subordinate manufacturing facility that is located on the same site as the manufacturing facility as a “manufacturing facility” for these purposes.

The Act also describes those physical components of a manufacturing facility that are “ancillary” and subject to a 25% limitation in the amount of bond issuance used to build or reconstruct such components.

F. Tribal Economic Development Bonds¹⁵

The Act allows tribal governments to issue up to \$2 billion of tax-exempt “tribal economic development bonds” to spur economic development on tribal lands. The Act requires the Secretary of Treasury to study whether this restriction should be repealed on a permanent basis. Such bonds cannot be used to finance any portion of a building where certain gaming activities are conducted or housed, or where property used to conduct gaming activities is housed.

G. Alternative Minimum Tax¹⁶

Interest on private activity bonds is generally treated as an item of tax preference under the minimum tax and included in income for purposes of calculating alternative minimum taxable income. Under the Act, interest on private activity bonds issued during 2009 and 2010 will not be treated as a preference item for purposes of calculating alternative minimum taxable income.

¹⁴ Act § 1301.

¹⁵ Act § 1402.

¹⁶ Act § 1503.

H. Tax Credit Bonds

Tax credit bonds and tax-exempt bonds provide a subsidy to State and local governments by reducing the cash interest payments that a State or local government must make on its debt. Tax credit bonds differ from tax-exempt bonds in that interest paid on tax credit bonds is taxable, and a portion of such interest takes the form of a tax credit. The tax credit offsets a portion of the cash interest payment that a State and local government would otherwise need to make on the borrowing.

The Act, for 2009 and 2010, provides State and local governments with the option of issuing a tax credit bond instead of a tax-exempt bond. Bonds issued under this provision are known as Build America Bonds.¹⁷

The Act also permits State and local governments to elect to receive a direct payment from the Federal government equal to the subsidy that would have otherwise been delivered through the tax credit for bonds.¹⁸ The Act provides transitional rules for coordination with state law. The Act provides that until a state provides otherwise, the interest on any taxable governmental bond and the amount of any credit under such bond is treated as exempt from Federal income tax for state income tax law purposes.

The Act adds a new Code section that permits regulated investment companies to pass through to their shareholders credits from tax credit bonds. The new provision also allows the tax credits from tax credit bonds to pass through to beneficiaries of real estate investment trusts (REITS).¹⁹

I. Labor Standards²⁰

The Act requires the labor standards described in chapter 31 of title 40 of the US Code to apply to projects financed with the proceeds of clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds, qualified school construction bonds, and recovery zone economic development bonds.

V. Energy Incentives

A. Advanced Energy Credit²¹

The bill establishes a new 30% investment tax credit for qualified investment in a “qualifying advanced energy project.” A qualifying advanced energy project is a project that re-equips, expands

¹⁷ Act § 1531(a).

¹⁸ Act § 1531(b).

¹⁹ Act § 1541.

²⁰ Act § 1601

²¹ Act § 1302.

or establishes a manufacturing facility for the production of (i) property designed to be used to produce energy from renewable resources, (ii) fuel cells, microturbines, or energy storage systems for use with electric or hybrid electric motor vehicles, (iii) electric grids to support the transmission of intermittent sources of renewable energy, (iv) property designed to capture and sequester carbon dioxide emissions, (v) property designed to refine or blend renewable fuels or to produce energy conservation technologies, (vi) new qualified plug-in electric drive motor vehicles, qualified plug-in electric vehicles or components designed to for use with such vehicles, or (vii) other advanced energy property designed to reduce greenhouse gas emissions.

These generous credits are available only for projects certified by the Secretary of the Treasury under a program established in consultation with the Secretary of Energy. A competitive bidding process applies. Up to \$2.3 billion of credits can be certified.

B. Extension of Energy Credit for Electricity Produced from Renewable Resources²²

The Act includes a three-year extension of the renewable energy production tax credit for wind facilities (through December 31, 2012) and for closed-loop biomass, open-loop biomass, geothermal, small irrigation, hydropower, landfill gas, waste-to-energy, and marine renewable facilities (through December 31, 2013).

C. Investment Credit in Lieu of Production Credit;²³ **Grants from Treasury**²⁴

Facilities that produce electricity from wind, closed-loop biomass, open-loop biomass, geothermal, small irrigation, hydropower, landfill gas, waste-to-energy, and marine renewable facilities are eligible for a production credit. The credit is spread over ten years and is dependent on the price for electricity. The Act permits owners of such facilities to claim a 30% investment tax credit when the property is placed in service in lieu of the production tax credit.

The Act permits taxpayers to receive grants from Treasury in lieu of production tax credits for certain renewable energy facilities and certain renewable energy property. The Treasury Department will issue a grant equal to 30% of the cost of the renewable energy facility within sixty days of the facility being placed in service (or, if later, within sixty days of receiving an application for the grant).

²² Act § 1101.

²³ Act § 1102.

²⁴ Act §§ 1104 and 1603.

D. Repeal of Subsidized Energy Financing Limitation on the ITC²⁵

The Act repeals the provision that required the investment credit to be reduced if the property qualifying for the credit was financed with tax-exempt industrial development bonds or through any other Federal, State or local government subsidized financing program.

E. Dollar Limitation on Certain Energy Credits²⁶

The Act removes the dollar limitations on certain energy credits for which individuals are eligible, including the credits for solar water heating property, small wind energy property, geothermal heat pumps.

F. Clean Renewable Energy Bonds (“CREBs”)²⁷

The Act authorizes an additional \$1.6 billion of clean renewable energy bonds to finance facilities that generate electricity from the following sources: wind, closed-loop biomass open-loop biomass, geothermal, small irrigation, hydropower, landfill gas, marine renewables and trash combustion facilities. This authorization will be subdivided into thirds: 1/3 will be available 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.

G. Qualified Energy Conservation Bonds²⁸

The Act authorizes an additional \$2.4 billion of qualified energy conservation bonds to finance State, municipal and tribal government programs and initiatives designed to reduce greenhouse gas emissions and other qualified conservation purposes.²⁹ The Act clarifies that qualified energy

²⁵ Act §§ 1103(b) and 1122.

²⁶ Act § 1103(a).

²⁷ Act § 1111.

²⁸ Act § 1112.

²⁹ The term “qualified conservation purpose” means: 1. Capital expenditures incurred for purposes of reducing energy consumption in publicly owned buildings by at least 20 percent; implementing green community programs; rural development involving the production of electricity from renewable energy resources; or any facility eligible for the production tax credit under I.R.C. § 45 (other than Indian coal and refined coal production facilities); 2. Expenditures with respect to facilities or grants that support research in: (A) development of cellulosic ethanol or other nonfossil fuels; (B) technologies for the capture and sequestration of carbon dioxide produced through the use of fossil fuels; (C) increasing the efficiency of existing technologies for producing nonfossil fuels; (D) automobile battery technologies and other technologies to reduce fossil fuel consumption in transportation; and (E) technologies to reduce energy use in buildings; 3. Mass commuting facilities and related facilities that reduce the consumption of energy, including expenditures to reduce pollution from vehicles used for mass commuting; 4. Demonstration projects designed to promote the commercialization of: (A) green building technology; (B) conversion of agricultural waste for use in the production of fuel or otherwise; (C) advanced battery manufacturing technologies; (D) technologies to reduce peak-use of electricity; and (D) technologies for the capture and sequestration of carbon dioxide emitted from combusting fossil

conservation bonds may be issued to make loans and grants for capital expenditures to implement green community projects and that for programs in which utilities provide ratepayers with energy-efficient property and recoup the costs of the property over an extended period of time.

H. Tax Credits for Energy-Efficient Improvements to Existing Homes³⁰

The Act extends through 2010 tax credits for improvements to energy-efficient existing homes. The Act increases the amount of the credit to 30% of the amount paid or incurred for qualified energy efficiency improvements. The Act eliminates the property-by-property dollar caps on the credits and provides an aggregate cap of \$1,500 on all property qualifying for the credit in a taxable year. The Act also updates the energy-efficiency standards for property qualifying for the credit.

I. Credits for Alternative Fueling Property³¹

The Act increases for 2009 and 2010 the 30% alternative refueling property credit for businesses to a 50% credit and increases the cap from \$30,000 to \$50,000. The credit for hydrogen refueling pumps remains at 30%, but the cap is raised to \$200,000. The Act also increases the 30% alternative refueling property credit for individuals to 50% and the cap from \$1,000 to \$2,000 for 2009 and 2010.

J. Plug-in Electric Drive Vehicle Credit³²

The Act expands and modifies tax credits for plug-in vehicles and accessories. First, the Act modifies the credit for plug-in vehicles. The base amount of the credit is \$2,500 and is increased if the vehicle draws propulsion from a battery with at least 5 kilowatt-hours capacity. This revised credit applies to vehicle purchases made after December 31, 2009.³³ Second, the Act allows a new credit of 10% of the cost of low-speed vehicles, motorcycles and 3-wheeled vehicles that would otherwise meet the criteria for qualified plug-in vehicle but for the fact that they are low speed or do not have four wheels, for purchases made after the date of enactment of the Act until December 31, 2011. The credit is capped at \$2,500. Third, the Act provides a credit for conversion of a vehicle into a plug-in vehicle through a conversion kit, in an amount equal to 10% of so much of the cost of converting that does not exceed \$40,000. The basis in a vehicle used in a trade or business will be reduced by any credit amount that is claimed with respect to that vehicle. In the case of a vehicle

fuels in order to produce electricity; and 5. Public education campaigns to promote energy efficiency (other than movies, concerts, and other events held primarily for entertainment purposes). Joint Committee on Taxation, JCX-10-09, pg. 29 (Jan. 23, 2009).

³⁰ Act § 1121.

³¹ Act § 1123.

³² Act §§ 1141 and 1143.

³³ Once the plug-in vehicle manufacturer has sold 200,000 units of the vehicle, the credit begins to decline in value.

used by a tax-exempt entity or a governmental entity, the credit may be claimed by the seller of the vehicle.

K. Sequestration Requirement for Carbon Dioxide Capture Tax Credit³⁴

The Act modifies the carbon dioxide capture tax credit by requiring any taxpayer claiming the credit to ensure that the carbon dioxide is permanently stored in a geologic formation.

L. Parity for Transit Benefits³⁵

The Act equalizes the tax-free benefit employers can provide for transit and parking from March 2011 through December 2010. The benefits are set at \$230 per month for 2009 and indexed for 2010.

VI. Other Credits

A. Expansion of Work Opportunity Tax Credit³⁶

The Act expands the work opportunity tax credit to include credits for hiring two new targeted groups of employees -- unemployed veterans and disconnected youth -- who begin work for the employer in 2009 or 2010. An individual qualifies as an unemployed veteran if he or she was released from active duty in the Armed Forces during the five-year period before hiring and he or she received unemployment compensation for more than four weeks during the year before being hired. A “disconnected youth” is an individual between the ages of 16 and 25 who has not been regularly employed or attended school in the six months preceding hiring and who is “not readily employable by reason of lacking a sufficient number of basic skills.”

B. New Markets Tax Credit³⁷

The Act enhances the new markets tax credit by authorizing an additional \$1.5 billion for the “2008” allocations and \$1.5 billion for the “2009” allocations. This increases the available credits each year to \$5 billion.

³⁴ Act § 1131.

³⁵ Act § 1151.

³⁶ Act § 1221.

³⁷ Act § 1403.

C. Low-Income Housing Grants in Lieu of Tax Credits³⁸

The Act allows taxpayers to receive a grant from the Treasury Department in lieu of low-income housing tax credits. State housing agencies would receive a grant in an amount up to 85% of 40% of the state's low-income housing tax credit allocation in lieu of credits. The grants would apply to each state's 2009 low-income housing tax credit allocation.

VII. S Corporations and Small Business Tax Relief

A. S Corporation Built-in Gains³⁹

The Act includes a temporary reduction in the built-in gains tax period for S corporations. Under present law, an S corporation that sells assets within ten years of converting from C corporation to S corporation status is subject to the built-in gains tax, a corporate tax on the built-in gain that existed at the time of the S election. The Act reduces the 10-year period to 7 years for sales occurring in tax years beginning in 2009 and 2010.

B. Qualified Small Business Stock⁴⁰

The Act increases the exclusion from income for gain on the sale of certain small business stock held by individuals for more than five years from 50% to 75%. The benefit would apply to stock issued after enactment and before 2011.

C. Estimated Taxes for Small Businesses⁴¹

The Act reduces the required estimated tax payments for 2009 for individuals receiving income from small businesses. The provision applies to an individual if the adjusted gross income shown on the individual's return for 2008 was less than \$500,000 and the individual certifies that more than half of the gross income shown on the individual's return for 2008 was income from a small business with average employment of less than 500.

³⁸ Act §§ 1404 and 1602.

³⁹ Act § 1251.

⁴⁰ Act § 1241.

⁴¹ Act § 1212.

VIII. Losses for Ownership Changes

A. Repeal of Treasury 382 Notice⁴²

The Act includes a provision that would prospectively repeal Treasury Notice 2008-83, which provided banks with an exception that allowed them to take greater advantage of the losses of the banks they acquire.⁴³ The Act would allow banks to use the losses if (i) an “ownership change” in the target bank occurred on or before January 16, 2009, (ii) there was a binding written agreement for such a change entered into on or before such date, or (iii) there was a written agreement and a public announcement of a plan for such change on or before such date.

B. Section 382 Relief⁴⁴

Section 382 of the Code limits the use of loss and credit carryovers after certain events resulting in a change in ownership of a corporation. The Act clarifies the application of section 382 to certain companies restructured pursuant to the EESA. Under the Act, the section 382 limitation will not apply in the case of an ownership change which is pursuant to a restructuring plan which (i) is required under a loan agreement or commitment for a line of credit entered into with the Department of the Treasury under EESA and (ii) “is intended to result in a rationalization of the costs, capitalization, and capacity with respect to the manufacturing workforce of, and suppliers to, the taxpayer and its subsidiaries.” The provision does not apply if immediately after the ownership change any person, other than a Voluntary Employment Benefit Association (“VEBA”), owns stock of the corporation possessing 50% or more of the combined voting power of all classes of stock entitled to vote.

IX. Provisions Indirectly Benefiting Businesses

A. Computers as Qualified Education Expenses in Section 529 Plans⁴⁵

The Act expands the definition of “qualified higher expenses” under section 529 of the Code to include expenses paid or incurred in 2009 or 2010 for the purchase of any computer technology or

⁴² Act § 1261.

⁴³ Internal Revenue Service Notice 2008-83, released on October 1, 2008, provides that “[f]or purposes of section 382(h), any deduction properly allowed after an ownership change (as defined in section 382(g)) to a bank with respect to losses on loans or bad debts (including any deduction for a reasonable addition to a reserve for bad debts) shall not be treated as a built-in loss or a deduction that is attributable to periods before the change date.” The Notice further states that the IRS and Treasury are examining the proper treatment under section 382(h) of certain items of deduction or loss allowed after an ownership change to a corporation that is a bank (as defined in section 581) both immediately before and after the change date, and that any such corporation may rely on the treatment set forth in Notice 2008-83 unless and until there is additional guidance.

⁴⁴ Act § 1262.

⁴⁵ Act § 1005.

equipment or Internet access and related services if such technology, equipment or services are to be used by the beneficiary of the section 529 account and the beneficiary's family during any of the years the beneficiary is enrolled at an eligible institution. That means that funds can be withdrawn tax-free from section 529 accounts for such use in 2009 or 2010.

B. Sales Tax Deduction for Vehicle Purchases⁴⁶

The Act provides taxpayers who itemize deductions (and do not deduct sales taxes in lieu of income taxes) with an itemized deduction for State and local sales and excise taxes paid on the purchase of new cars, light trucks, recreational vehicles, and motorcycles in 2009. Taxpayers who do not itemize also may claim the deduction as an increased standard deduction. The deduction is phased out for taxpayers with adjusted gross income in excess of \$125,000 (\$250,000 for a joint return). Only taxes attributable to the portion of the purchase price that does not exceed \$49,500 may be deducted.

X. Other Provisions of Interest to Business Owners

A. Extension of AMT Relief for 2009⁴⁷

The Act extends tax relief from the individual alternative minimum tax for 2009 by allowing nonrefundable credits to be claimed against the tax and by increasing the AMT exemption amount to \$70,950 for joint filers and \$46,700 for individuals.

XI. Provisions Not Included in the Act

The Act **does not include** certain important business-related provisions that were included in the House bill, the Senate bill or both bills. These include:

- Special five-year net operating loss carryback period for all taxpayers.
- Extension of business credit carryback period.
- Allowance of business credits claimed during 2008 and 2009 to offset entire net tax liability (including minimum tax liability).
- Provision allowing alternative minimum tax NOL carrybacks and carryforwards from 2008 and 2009 to reduce alternative minimum taxable income to zero.
- Investment tax credit for qualified broadband expenditures.

⁴⁶ Act § 1008.

⁴⁷ Act §§ 1011 and 1012.