Stimulus Bill Up For Vote Contains Significant Debt Tax Relief

Conferees appointed by the House of Representatives and the Senate agreed yesterday to a version of the stimulus bill (The American Recovery and Reinvestment Act of 2009) which provides significant tax relief for debt issuers, including relief from cancellation of debt income (CODI). As explained below, the debt-related provisions contained in the conference agreement are more favorable to taxpayers than those contained in the bill passed by the Senate earlier this week.

The conference agreement also includes a limited number of additional business tax relief provisions, including an extended net operating loss (NOL) carryback period, relief for S corporation built-in gains, increased depreciation deductions, and tax breaks for capital gains on certain small business stocks. These provisions generally cover topics addressed in the Senate bill, but in some cases are substantially less favorable to taxpayers.

Debt Tax Relief

The conference agreement contains CODI relief that applies to a broad range of transactions, including debt-for-debt and debt-for-equity exchanges, and debt modifications, as well as cash purchases. Under the conference agreement, a taxpayer generally may elect to defer CODI incurred on the repurchase of debt in 2009 or 2010 to 2014, and then to spread the income over a 5-year period beginning with 2014. If a taxpayer makes this election, certain related deductions for original issue discount arising as a result of a debt-for-debt exchange (or as a result of the issuance of new debt whose proceeds are used to retire existing debt at a discount) would be similarly deferred.

The conference agreement adds limited relief in the context of a debt-for-debt exchange from the "applicable high-yield discount obligation" (AHYDO) rules, which defer and in some cases disallow interest deductions on AHYDOs. The conference agreement provides that most obligations issued during the period beginning on September 1, 2008, and ending on December 31, 2009, will not be treated as AHYDOs if such obligations are issued in exchange for non-AHYDOs, including exchanges that are deemed to occur because of a significant modification of the debt instrument. It also authorizes the Treasury Secretary to suspend the application of the AHYDO rules or permit reference to an interest rate higher than the customary "applicable Federal rate" in determining whether an instrument issued after December 31, 2009, is an AHYDO, "if the Secretary determines that such suspension is appropriate in light of distressed conditions in the debt capital markets."

These provisions are generally more favorable to taxpayers than those in the Senate bill, which would have spread CODI realized in 2009 or 2010 over an 8-year period beginning in 2011, and did not include AHYDO relief.

NOL Carrybacks

The conference agreement allows corporations with average annual gross receipts of $15 million or less (measured over the 3-taxable-year period ending with the prior taxable year) to elect to carry back NOLs realized in taxable years that begin in or end in 2008 for up to five taxable years. This provision is substantially scaled back from the Senate version, which applied to most corporate taxpayers, regardless of their gross receipts, and to NOLs realized in taxable years that begin in or end in 2008 or 2009.

S Corporation Built-In Gains Tax Relief

The conference agreement adopts the provision in the Senate bill on S corporation built-in gains tax relief. The provision eliminates corporate-level tax on most "built-in gains" recognized by an S corporation in taxable years beginning in 2009 or 2010 if the corporation was an S corporation for at least seven taxable years before the year in which such gains are recognized. The provision does not apply to built-in gains recognized as a result of an S corporation's distribution of appreciated assets.

Other Provisions

The conference agreement also contains provisions that allow greater bonus depreciation deductions, permit the costs of certain new investments to be expensed, and increase the exclusion for capital gains realized on sales of certain small corporation stock if the stock was purchased after the date of enactment of the bill and before 2011.

Next Steps

The House and Senate are scheduled to vote on the stimulus bill today or tomorrow (February 13 or 14, 2009), with the goal of providing President Obama with a bill that can be signed by Monday, February 16 (Presidents' Day). We will continue to alert you to further legislative developments.

If you have any questions regarding the stimulus bill, please contact a member of the Tax & Benefits Department.

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