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February 2009

TAX UPDATE

**American Recovery and Reinvestment Act of 2009**

The following is a brief discussion of the tax provisions contained in the American Recovery and Reinvestment Act of 2009 (the “Act”).

**TAX IMPLICATIONS FOR BUSINESS**

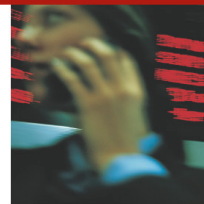
**Section 179 expensing.** The Act extends the increased Section 179 expensing amounts currently available for the 2008 taxable year to property acquired and placed in service in 2009 (\$250,000 maximum expensing and an \$800,000 phase-out ceiling).

**Bonus depreciation.** The Act extends the first-year 50 percent bonus depreciation to property acquired and placed in service in 2009 (to 2010 for transportation property, certain aircraft and certain longer-lived property).

**Net operating loss (NOL) carrybacks.** Under the Act, businesses with gross receipts of \$15 million or less will have the choice to carry back NOLs either three, four or five years (instead of the two-year carryback provided under current law). The five-year carryback is effective for NOLs generated in tax years ending or (at the taxpayer’s election) beginning in 2008.

**Work opportunity tax credit (WOTC).** Under current law, businesses are allowed to claim a credit equal to 40 percent of the first \$6,000 in wages paid to employees of one of nine targeted groups. The Act expands the WOTC to include two new targeted groups who begin work for an employer during 2009 or 2010: unemployed veterans and disconnected youths. Individuals qualify as unemployed veterans if they were discharged or released from active duty from the armed forces during the five-year period prior to hiring and received unemployment compensation for more than four weeks during the year before being hired. Individuals qualify as disconnected youths if they are between the ages of 16 and 25, have not been regularly employed or attended school in the past six months and are not readily employable by reason of lacking a sufficient number of basic skills.

**Refundable credits in lieu of bonus depreciation.** Under current law, corporations eligible for bonus depreciation are entitled to claim additional refundable research or alternative minimum tax credits in lieu of claiming bonus depreciation. This provision allows taxpayers operating at a loss who are unable to benefit from bonus depreciation to monetize the benefit of bonus depreciation through refundable credits. The election to forego bonus depreciation currently applies to property placed in service after March 31, 2008 and before January 1, 2009. The Act extends the provision to property placed in service before January 1, 2010.



***Deferral of certain income from discharge of indebtedness.*** Under the Act, certain cancellation of debt (COD) income realized on account of a taxpayer's or a related person's reacquisition of a debt instrument during 2009 or 2010 would be, at the taxpayer's election, deferred until 2014 and then included in income ratably over five years (2014 to 2018). This relief provision applies to debt repurchases for cash, debt-for-debt exchanges (including modifications), debt-for-equity exchanges, contributions to capital and complete forgiveness by the holder of the instrument. The Act also contains limits on the issuer's ability to deduct original issue discount (OID) accruing during the deferral period.

***Suspension of rules governing applicable high-yield discount obligation (AHYDO).*** The Act provides temporary relief from the AHYDO rules for certain exchanges of debt instruments, including exchanges deemed to result from the modification of debt instruments. Generally, the AHYDO rules apply to corporate debt instruments with a term of more than five years, a yield to maturity at least 5 percent above the applicable federal rate (AFR) and "significant original issue discount." Where applicable, the AHYDO rules defer a corporation's deductions for OID until payment, and in some cases, disallow OID deductions entirely. Given current AFR rates, many corporations seeking to restructure existing debt obligations have been faced with the potential application of the AHYDO rules. Under the Act, the AHYDO rules will not apply to any debt instrument issued between September 1, 2008 and December 31, 2009 in exchange (including an exchange resulting from a modification of the debt instrument) for a debt instrument that is not an AHYDO, provided that the issuer (or obligor) of both debt instruments is the same. In addition, the Act grants the secretary of the Treasury Department the authority to use a rate higher than the AFR to determine whether the AHYDO rules will apply to debt instruments issued after December 31, 2009, if the secretary determines that a higher rate is appropriate in light of distressed conditions in the debt capital markets.

***Estimated tax payment relief.*** The Act reduces the 2009 required estimated tax payments for certain small businesses.

***Qualified small business stock.*** The Act increases the exclusion for individuals for gain from the sale of certain small business stock held for more than five years from 50 percent to 75 percent. The increased exclusion applies to gain from the sale of small business stock acquired after the enactment of the Act and before 2011.

***Repeal of Notice 2008-83.*** The Act prospectively repeals Notice 2008-83, under which the Internal Revenue Service indicated that an acquired bank's post-ownership change losses on loans or bad debts are not treated as "built-in losses" for purposes of the Section 382 loss limitation rules. Notice 2008-83 is deemed to have the force and effect of law for any ownership change occurring on or before January 16, 2009, and for any ownership change occurring after January 16, 2009 if the change is under a written binding contract entered into on or before January 16, 2009; or is under a written agreement entered into on or before January 16, 2009 and the agreement was described on or before January 16, 2009 in a public announcement or in a filing with the Securities and Exchange Commission required by reason of the ownership change. The Act clarifies the



application of Section 382 to certain companies restructuring pursuant to the Emergency Economic Stabilization Act of 2008.

***S corporation built-in gain.*** The Act temporarily reduces the S corporation built-in gains holding period from 10 years to seven for C corporations that convert to an S corporation in tax years beginning in 2009 or 2010.

***New market tax credits (NMTC).*** The Act expands the NMTC program by authorizing an additional \$1.5 billion for each of 2008 and 2009.

***Low-income housing credit (LIHTC).*** The Act contains a provision that would allow states to issue cash grants in lieu of the LIHTC.

***Executive compensation.*** The Act prescribes various executive compensation limitations applicable to participants in the Troubled Asset Relief Program (TARP) and delegates authority to the Treasury Department to prescribe specific rules governing the executive compensation practices of companies participating in TARP.

#### **TAX RELIEF FOR INDIVIDUALS AND FAMILIES**

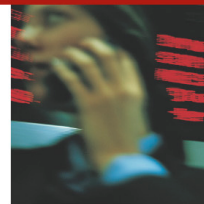
***Making Work Pay credit.*** The Act creates a temporary refundable tax credit of up to \$400 for working individuals and \$800 for working families, calculated at a rate of 6.2 percent of earned income, and phased out at adjusted gross income (AGI) in excess of \$75,000 (\$150,000 for married couples filing jointly). The credit will be applied retroactively to 2009 and will extend through 2010.

***Expanded earned income tax credit (EITC).*** The Act provides an expanded EITC that temporarily increases the EITC from 40 percent to 45 percent of a family's first \$12,570 of earned income for families with three or more children. The Act increases the beginning point of the phase-out range for all married couples filing a joint return (regardless of the number of children) to \$5,000.

***Expanded child tax credit.*** The Act increases the eligibility for the refundable child tax credit in 2009 and 2010. Under present law, the child tax credit is refundable only to the extent of 15 percent of the taxpayer's earned income in excess of \$8,500. Under the Act, the \$8,500 floor is reduced to \$3,000 for 2009 and 2010.

***AMT patch.*** The Act includes a one-year patch of the AMT, a \$69.8 billion measure that will protect 26 million families from the AMT.

***American Opportunity tax credit.*** The Act temporarily enhances the Hope credit for 2009 and 2010 (renaming it the American Opportunity tax credit). The enhanced credit provides a tax credit of up to \$2,500 of the cost of tuition and related expenses (including books and other required course materials) paid during the tax year. The credit is based on 100 percent of the first \$2,000 and 25 percent of the next \$2,000 of tuition and related expenses paid during the tax year. The



credit phases out for AGI in excess of \$80,000 (\$160,000 for married couples filing jointly), and 40 percent of the credit is refundable.

***Section 529 plans.*** The Act provides that expenses paid or incurred for the purchase of computer technology and equipment or Internet access qualify as qualified education expenses under Section 529 plans for tax years beginning in 2009 and 2010.

***First-time homebuyer credit.*** The first-time homebuyer credit is extended to apply to homes purchased after December 31, 2008 and before December 1, 2009. The Act removes the repayment requirement for homes purchased during 2009 unless the home is resold within 36 months of purchase. The Act also increases the amount of the credit from the current maximum of \$7,500 to up to \$8,000.

***Unemployment compensation benefits.*** The Act provides a temporary suspension of federal income tax on the first \$2,400 of unemployment benefits received by a recipient in 2009.

***Economic recovery payment.*** The Act provides for a one-time payment of \$250 to retirees, disabled individuals and Social Security beneficiaries and SSI recipients receiving benefits from the Social Security Administration and railroad retirement beneficiaries, and to veterans receiving disability compensation and pension benefits from the U.S. Department of Veterans' Affairs. Any allowable Making Work Pay credit otherwise available to a recipient would be reduced by the amount of the economic recovery payment.

***Refundable credit for federal and state pensioners.*** The Act provides a one-time refundable credit of \$250 in 2009 to certain governmental retirees who are ineligible for Social Security benefits. The credit reduces any allowable Making Work Pay credit otherwise available to a recipient.

***Transportation benefits.*** The Act increases the maximum monthly exclusion for employer-provided transit and vanpool benefits (\$120 for 2009) to the same level as the exclusion for employer-provided parking (\$230 for 2009) for 2009 and 2010.

***Automobile purchase relief.*** The Act provides an above-the-line deduction to individuals purchasing a new car, light truck, recreational vehicle or motorcycle during 2009 for state sales or excise tax paid on the purchase. The deduction applies to the tax attributable to the first \$49,500 of purchase price and begins to phase out at AGI in excess of \$125,000 (\$250,000 for married couples filing jointly).

## **ENERGY INCENTIVES**

***Renewable energy production tax credit.*** The Act extends the Section 45 renewable energy production tax credit, extending the placed-in-service date for wind facilities for three years through December 31, 2013, and for certain other qualifying facilities for three years through December 31, 2014.



***Election to claim investment tax credit.*** Under current law, facilities that produce electricity from solar facilities and certain other property are eligible to take a 30 percent investment tax credit in the year that the facility is placed in service. Facilities that produce electricity from wind (in addition to small wind energy property), closed-loop biomass, open-loop biomass, geothermal, hydropower, landfill gas, waste-to-energy and marine renewable facilities are now eligible for a production tax credit. The Act allows such facilities to elect to claim the investment tax credit in lieu of the production tax credit.

***Subsidized energy financing.*** The Act repeals the subsidized energy financing limitation on the energy investment credit.

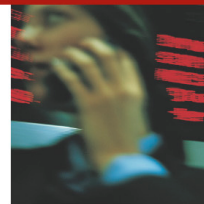
***Enhanced energy credit.*** Under current law, businesses are allowed to claim a 30 percent tax credit for qualified small wind energy property, capped at \$4,000. The Act eliminates the \$4,000 cap.

***Advanced energy investment credit.*** The Act adds new Section 48C, establishing a 30 percent investment tax credit for qualifying advanced energy projects. The credit is equal to 30 percent of the basis of qualified advanced energy property placed in service during the year. Advanced energy property includes technology for the production of renewable energy, energy storage, energy conservation, efficient transmission and distribution of electricity and carbon capture and sequestration. The total amount of credits available under this section are \$2.3 billion, and taxpayers will have to apply for certification to take the new credit. If a credit is otherwise allowed under Sections 48, 48A or 48B, the taxpayer is ineligible for the new credit.

***Enhanced alternative refueling property credit.*** The Act provides an increase for 2009 and 2010 for the Section 30C alternative refueling property credit for businesses from 30 percent (capped at \$30,000) to 50 percent (capped at \$50,000). Hydrogen refueling pumps remain at a 30 percent credit, but the cap for hydrogen refueling property is increased to \$200,000. For individuals, the credit is increased from 30 percent (capped at \$1,000) to 50 percent (capped at \$2,000).

***Improvements to energy-efficient existing homes.*** The Act extends the Section 25C tax credits for improvements to energy-efficient existing homes through 2010. For 2009 and 2010, the amount of the credit is increased from 10 percent to 30 percent of the amount paid or incurred by the taxpayer for qualified energy efficiency improvements during the tax year. An aggregate \$1,500 cap applies to all property qualifying for the credit, in lieu of the current law property-by-property dollar caps. Improvements eligible for the credit include insulation materials, exterior windows (including skylights), exterior doors, central air conditioners, certain metal roofs and advanced main air circulating fans.

***Plug-in electric drive motor vehicle credit.*** The Act modifies and increases a recently enacted tax credit for qualified plug-in electric drive vehicles placed in service during the taxable year. Under the Act, the base amount of the credit is \$2,500. If the qualified vehicle draws propulsion from a battery with at least five kilowatt hours of capacity, the credit is increased by \$417, plus another \$417 for each kilowatt hour of battery capacity in excess of five kilowatt hours up to 16 kilowatt hours. The credit begins to phase out once the amount of qualifying vehicles sold in the United



States after December 31, 2009 reaches 200,000. A qualified plug-in electric drive motor vehicle is a motor vehicle that has at least four wheels, is manufactured for use on public roads, meets certain emissions standards (except for certain heavy vehicles), draws propulsion using a traction battery with at least four kilowatt hours of capacity, and is capable of being recharged from an external source of electricity. The credit is available to both businesses and individuals.

#### **FOR MORE INFORMATION**

If you have questions about the American Recovery and Reinvestment Tax Act of 2009, please contact any member of our Tax group. For a list of our Tax lawyers, go to [www.ThompsonHine.com/practices/taxation/](http://www.ThompsonHine.com/practices/taxation/).

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