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CLIENT ALERT

February 2009

The American Recovery and Reinvestment Tax Act of 2009

On February 17, 2009, President Barack Obama signed into law the economic stimulus package entitled the American Recovery and Reinvestment Tax Act of 2009 (the Act). The cost of the Act is $787 billion and consists of (1) $287 billion in tax breaks, the vast majority of which are tax cuts or credits for low and middle income workers; (2) $192 billion in direct aid to states and individuals to increase Medicaid payments, jobless benefits and health care programs; and (3) $308 billion in discretionary spending for education, infrastructure, energy, and health and science research. This Client Alert, prepared by Gallagher's tax lawyers, highlights many of the important provisions of the Act in the areas of low-income and affordable housing, renewable energy, bonds and small business and individual tax breaks.

LIHTC and Affordable Housing Provisions

LIHTC Monetization Program The monetization program permits state tax credit allocating agencies (SAAs) to return to the U.S. Treasury (i) any unused housing tax credit ceiling for 2008, plus (ii) any low income housing tax credits (LIHTCs) returned in 2009 from prior years' allocations, plus (iii) 40% of the state's 2009 allocation, plus (iv) 40% of the state's share of the national pool of LIHTCs allocated in 2009. In return, the SAAs receive cash equal to 85% of the ten year credit amount for the returned LIHTCs. For example, if the State of Maryland has $11 million of LIHTCs to allocate in 2009, it could elect to transfer up to 40% of this amount or $4.4 million to the Treasury and receive a grant of $37.4 million from the Treasury. The State of Maryland would then have $6.6 million of LIHTCs to allocate in 2009.

The SAAs can use these monies to make subawards to projects to finance the construction, acquisition or rehabilitation of low-income buildings as defined under the LIHTC program. These awards may be made to a project regardless of whether the project has or will receive an allocation of LIHTCs. In making a subaward, the SAA is required to make the determination that the subaward to the project will increase the total funds available to the state to build and rehabilitate affordable housing. In conjunction with this determination, the SAA must establish a process in which subaward candidates demonstrate good faith efforts to obtain a traditional equity commitment from a LIHTC investor before the SAA makes the subaward. The subaward is made in the same competitive manner as the allocation of the LIHTCs, and requires compliance with rent, income and use restrictions for the building to be financed. The SAA is empowered to ensure compliance with Section 42. The failure of the project to comply with Section 42 will result in recapture of the grant by means of a lien or other method approved by Treasury. Any funds not awarded by an SAA by December 31, 2010, must be returned to Treasury. According to the Act's joint committee report, grants made by the SAAs under this program are not taxable to the recipients, however this language is not in the Act. The Act does provide that the basis of the building is not reduced by receipt of the grant.

Further guidance from the IRS and the SAAs will be required to understand how the program will be implemented. For instance, how will SAAs determine if the subaward would increase the total funds available to the state for affordable housing? Will the SAA take into account a commitment of equity at any level or only at or above $.85 in determining total funds available to the state for affordable housing and in determining a good faith effort to obtain an investor? Once subawards are made, how will SAAs fund the subawards, upfront or on a schedule similar to equity contributions? What is the process for returning past years' credits? Will projects with 2008 allocations and equity commitments (that are not yet closed) simply be able to turn in their allocations for a subaward? Under what circumstances would the subaward become repayable, and will the repayment provisions be similar to the LIHTC recapture provisions? How will SAAs asset manage and enforce compliance with Section 42? Many of the answers to these questions will require revisions to state qualified allocation plans and procedures.

HOME FUNDS (Gap Financing) HUD will provide an additional $2.25 billion in HOME funds to SAAs for only LIHTC projects based upon the 2008 HOME apportionment formula. The SAAs must award the HOME Funds no later than September 30, 2009. The funds will remain available through September 30, 2011. The SAAs are required to distribute the funds competitively pursuant to their qualified allocation plans to owners of LIHTC projects that have received or receive simultaneously with the HOME funds an award of LIHTCs. The term "award" is not defined by the Act. Further guidance is required as to whether an award is defined as an allocation of LIHTCs, or simply a reservation of LIHTCs. Further guidance will also be required as to when LIHTCs are awarded for projects qualifying for LIHTCs with tax-exempt bonds. It is also unclear if these funds may be used in deals where LIHTCs have previously been awarded but have been returned under the monetization program described above.

The SAAs are required to commit at least 75% of the funds within one year of the Act's enactment and project owners must expend 75% of the funds within two years, and 100% within three years. The funds may be used for projects receiving an award of LIHTCs within the 2007, 2008 or 2009 fiscal years. SAAs are required to give priority to projects that are expected to be completed within three years of enactment. The award of HOME funds is required to be made in the same manner and subject to the same limitations (including income, rent and use restrictions) as required by the SAAs with respect to the award of LIHTCs. The eligible basis of a project is not reduced by a grant of these funds, however, a grant of funds would result in income to the project owner.

Other Affordable Housing Provisions:

Public Housing Capital Fund The Act provides $4 billion in public housing capital funds of which $3 billion will be distributed by formula and $1 billion will be distributed based on a competitive process for priority investments, including investments that leverage private sector financing and energy conservation retrofits. Priority will be given to public housing projects underway, those that can award contracts within 120 days and those included in five year capital fund plans. One hundred percent of the funds must be obligated within one year of the funds becoming available to public housing agencies, 60% must be expended within two years of the date funds become available to the public housing agencies and 100% within three years. These funds may not be used for operating or rental subsidies.

Project Based Rental Assistance The Act provides $2.25 billion for additional project based rental assistance for Section 8, Section 202, and Section 811 programs of which $250 million are to be used for grants or loans to energy retrofit or make green

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Home Purchase Credit Prior to the Act, eligible first time homebuyers could claim a refundable tax credit equal to the lesser of 10% of the purchase price of the principal residence and $7,500. The credit was then recaptured over 15 years with no interest charged. With the recapture, the credit amounted to a zero percent loan. The Act, for purchases on or after January 1, 2009 and before December 1, 2009, generally waives recapture unless the taxpayer disposes of the home or the home otherwise ceases to be the taxpayer's principal residence within 36 months from the date of purchase. The Act also increases the credit to $8,000. The credit phases out for individuals with adjusted gross income (AGI) between $75,000 and $95,000 ($150,000 to $190,000 for joint filers).

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Renewable Energy Provisions

Extension of Renewable Energy Production Credits The placed in service date has been extended for three years for certain facilities qualifying for the renewable energy production credit described in Section 45. The placed in service deadline for wind facilities is now December 31, 2012. The placed in service deadline for the following other facilities is now December 31, 2013: closed-loop biomass facilities, open-loop biomass facilities, geothermal or solar energy facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic renewable energy facilities.

Election of Investment Credit in Lieu of Production Credit Under Section 45, owners of certain energy-producing facilities (see previous paragraph) may earn an annual tax credit based upon the facility's energy production. Under Section 48, certain energy property may earn a 30% investment tax credit in the year the facility is placed in service (based upon the basis of the property placed in service). The Act permits a taxpayer to make an irrevocable election to have any of the production credit facilities listed in the paragraph above earn the 30% investment tax credit under Section 48 in lieu of the Section 45 production credit. A taxpayer may not earn credits under both Section 48 and Section 45. The provision applies to facilities placed in service after December 31, 2008 and before the applicable Section 45 production credit deadline, extended by the Act, as described in the paragraph above.

No Reduction of Investment Tax Credit Section 48 energy property, including solar-related energy property, which is financed with (i) subsidies from a Federal, State or local program or (ii) the proceeds of tax-exempt private activity bonds, is no longer subject to a basis

reduction in calculating the 30% investment tax credit. This provision applies to basis attributable to construction performed after December 31, 2008.

Grants for Energy Property in Lieu of Tax Credit Upon request by the taxpayer, the Secretary of the Treasury shall provide a grant to a taxpayer to reimburse the taxpayer for a portion of the expense of specified energy property which the taxpayer places in service. The grant funds are designed to take the place of production or investment credits that the specified energy property would otherwise qualify for. Specified energy property includes property constituting most of the facilities described in Section 45 (production credit), including wind, solar, and biomass facilities, as well as certain property described in Section 48 (investment credit), including solar, qualified fuel cell and geothermal property. The grant is restricted to specified energy property placed in service (i) during 2009 or 2010 or (ii) after 2010 (only if construction of the property began in 2009 or 2010), but before the credit termination date (which is January 1, 2013 for wind facilities eligible for the production credit; January 1, 2014 for other facilities such as biomass facilities and solar energy facilities eligible for the production credit; and January 1, 2017 for Section 48 energy property, including the 30% credit for solar panels). Taxpayers must submit a request before October 1, 2011 to be eligible for the grant.

The amount of the grant for most qualifying property, including Section 45 (production credit) property, is 30% of the property's basis. Certain Section 48 (investment credit) property is limited to a 10% credit. The amounts of the grants are not includible in the gross income of the taxpayer, but the basis of the property is reduced by fifty percent of the amount of the grant. The grants are made within 60 days after the later of the date of the grant request or the placed in service date of the property. Governments (and political subdivisions, agencies, or instrumentalities thereof), tax-exempt entities and partnerships having a partner which is a governmental or tax-exempt entity, are not eligible to receive the grant.

Properties receiving a grant are not eligible for the Section 45 credit (production) or Section 48 credit (investment) for the taxable year in which the grant is made or any subsequent year. If Section 48 (investment) credits were awarded for taxable years before a grant is made, then such credits are subject to recapture.

Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds The Act authorizes an additional $1.6 billion of clean renewable energy bonds (for a total of $2.4 billion). The Act also authorizes the issuance of $2.4 billion of additional qualified energy conservation bonds (QECBs), for a total of $3.2 billion. The Act clarifies that QECBs may be issued to make loans and grants for capital expenditures to implement green community programs.

Renewable Energy Loan Guarantees The Act provides for an additional $6 billion to pay the cost of loan guarantees authorized by the Energy Policy Act of 2005. The guarantees enable the federal government to share some of the financial risks of projects that employ new or significantly improved energy technologies that avoid, reduce, or sequester air pollutants and greenhouse gases.

New Markets Tax Credit

The Act increases the amount of New Markets Tax Credit (NMTC) allocation to $5 billion for each of 2008 and 2009. The increase in the 2008 NMTC allocation must be allocated to entities that submitted an allocation in 2008 for NMTC, but which did not receive any allocation or the full amount of the allocation request for 2008.

Significant Tax Incentives For Businesses

Extension of Bonus Depreciation The Act extends the election for bonus depreciation (immediate write-off of 50% of the cost of depreciable property) for depreciable property acquired and placed in service in 2009, and in 2010 for certain transportation or longer-lived property. The property must have a depreciable life of 20 years or less, so buildings are excluded, and the original use of the property must be with the taxpayer. The taxpayer may elect not to take bonus depreciation, for instance in cases where it has expiring net operating losses.

Extension of Section 179 Expensing The Act extends the ability of taxpayers to elect to deduct as an expense, rather than depreciate, the costs of tangible personal property used in a trade or business and placed in service in 2009. The Act increases the 179 deduction to $250,000 from $133,000. The deduction cannot exceed the taxpayer's income but may be carried forward. The amount that may be expensed is reduced by every dollar the taxpayer's capital expenditures exceeds $800,000. For example, if a taxpayer places in service $900,000 of tangible personal property used in a trade or business in 2009, the taxpayer could deduct $150,000 under this provision. Any amounts deducted under Section 179 are applied before the bonus depreciation calculation.

Carryback of Net Operating Losses Pre-Act, taxpayers were generally allowed to carryback losses two years. The Act permits losses to be carried back up to five years. The provision applies to NOLs from tax years beginning in 2008 and 2009. This provision only applies to small businesses whose gross receipts do not exceed $15,000,000.

Deferral of Cancellation of Indebtedness Income The Act permits the deferral of any income from discharge of indebtedness that results from a taxpayer's repurchase in 2009 or 2010 of an applicable debt instrument issued by the taxpayer. The deferred income is included in taxable income ratably over a five-taxable year period beginning in 2014. An applicable debt instrument is generally any contractual arrangement, bond, certificate or note constituting indebtedness. A repurchase includes an acquisition by the issuer or related party of the existing debt instrument for cash, upon the material modification of an existing debt instrument, upon an exchange of an existing debt instrument for a new debt instrument, upon the exchange of the existing debt instrument for stock or a partnership interest, upon a contribution to capital of the existing debt instrument, or upon the complete forgiveness of the existing debt instrument. Partners of partnerships or other pass-through entities electing to defer cancellation of indebtedness income will not be deemed to receive a distribution due to the reduced debt to the extent such distribution exceeds the basis of the partner's partnership interest. The deemed distribution is taken into account at the time the deferred income is recognized by the partner.

A debtor who makes the deferral may not use the exclusion for bankruptcy, insolvency, or qualified real property indebtedness for the debt discharge for the tax year of the election or later taxable year. The election for partnerships is made at the partnership level, so careful consideration must be given to the status of the partners since the exclusions described above may not be used by the partners with respect to the debt discharge from the debt instrument if the election is made. The election is irrevocable and is made on a debt-by-debt basis. The deferral is accelerated and taken into income in the taxable year in which a taxpayer dies, liquidates, sells substantially all of its assets, ceases to do business, or upon the sale or exchange of an interest in a partnership or other pass-through entity. In the case of a

bankruptcy, any deferred income is generally treated as income on the date before the bankruptcy petition is filed.

Reduction in S Corporation Built-in Gains Holding Period Under current law, a corporation may convert to an S corporation tax free; however, any built-in gains recognized during the S corporation's first ten years are subject to corporate tax. For built-in gains that otherwise would have been recognized in tax years beginning in 2009 and 2010, no built-in gain is recognized if the S corporation has been in existence (as an S corporation and not merely a corporation) for at least seven tax years prior to 2009 or 2010, respectively.

Bond Provisions

Build America Bonds A build America bond is any obligation, other than a private activity bond, if the interest on such obligation would, but for this provision, be excludable from gross income under Section 103, and such obligation is issued after February 17, 2009 and before January 1, 2011. If an issuer elects to have a bond qualify as a build America bond, then such bond becomes a taxable bond. At the election of the issuer, the Act provides for either (i) a federal tax credit to the holder of the build America bond in the amount of 35% of the interest payable to the holder by the issuer or (ii) a direct payment from the federal government to the issuer in the amount of the credits that would have been provided to the holder in item (i). The payments from the federal government to the issuer in item (ii) above are paid when the interest payments on the bonds are due, rather than as a lump sum. The interest paid to the holders of build America bonds and the credits awarded to the holders are both taxable.

Industrial Development Bonds The Act expands the definition of "manufacturing facilities" which may be financed with the proceeds of tax-exempt bonds. Manufacturing facilities now include facilities used in the creation or production of intangible property such as any patent, copyright, formula, process, design, pattern, knowhow, format or other similar item. This expanded definition applies to bonds issued in 2009 (after the effective date of the Act) and 2010.

Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds The Act authorizes $10 billion of recovery zone economic development bonds and $15 billion of recovery zone facility bonds. Recovery zones are areas designated by the issuer based upon factors such as poverty rate and unemployment rate. Each are tax credit bonds which must be issued in 2009 or 2010. The bond authority will be allocated among the states based upon each state's employment decline as compared to the national average. The states then further allocate their allocation to their counties and large municipalities based upon employment decline rates. The recovery zone economic development bonds are to be used to invest in infrastructure, public facilities, job training and educational programs. The recovery zone facility bonds are to be used to invest in property constructed, renovated or acquired by purchase and to be used in a trade or business within a recovery zone.

Tax-Exempt Interest Expense of Financial Institutions Financial institutions are not permitted to deduct the portion of their interest expense that is allocable to the tax-exempt bonds that they own. The Act modifies the formula used to calculate the portion of interest allocable to the tax-exempt bonds the financial institutions own, so that tax-exempt obligations issued in 2009 or 2010 are not taken into account. The amount of tax-exempt obligations not taken into account by reason of this new rule may not exceed two percent of the average adjusted bases for all assets of the financial institution. In addition, with respect to "qualified small issuer" bonds, the Act modifies the rule that exempts such bonds from the amount of tax-

exempt obligations in the interest disallowance calculation. The Act increases from $10,000,000 to $30,000,000, the amount of bonds that can be issued by a "qualified small issuer" in determining whether a bond issued in 2009 or 2010 qualifies for the small issuer exemption. In the case of a qualified 501(c)(3) bond issued during 2009 or 2010, the nonprofit organization for whose benefit such bond was issued will be treated as the issuer.

Tax-Exempt Interest Not Subject to AMT Tax-exempt interest on a private activity bond issued in 2009 or 2010 is not subject to the alternative minimum tax. A refunding bond is eligible for this exemption if the bond being refunded was issued in 2004 through 2008.

Qualified School Construction Bonds and Qualified Zone Academy Bonds The Act provides for the issuance of qualified school construction bonds (tax credit bonds) in the amount of $11 billion in each of 2009 and 2010. This amount is allocated among the states, with the proceeds to be used for the construction, rehabilitation, or repair of public school facilities. The national limitation for qualified zone academy bonds (tax credit bonds) is increased to $1.4 billion for each of 2009 and 2010.

Significant Individual and Family Tax Provisions

Making Work Pay Credit The Act provides a tax credit equal to 6.2% of a taxpayer's earned income. The credit is capped at $400 for individuals and $800 for joint filers. The credit is available in 2009 and 2010 and is refundable. The credit begins phasing out for individual taxpayers with an AGI of $75,000 ($150,000 for married filing jointly) and is completely phased out for individual AGIs of $95,000 ($190,000 for married filing jointly). The credit is not considered income to recipient nor considered as a resource for purpose of determining eligibility under any federal program. This credit costs $114 billion or more than 14% of the cost of the stimulus package.

American Opportunity Work Credit The Act creates a tax credit of up to $2,500 per student per year for qualified costs for the first four years of college. The credit rate is equal to 100% of the first $2,000 of qualified expenses and 25% of the next $2,000 of expenses. The credit phases out for individual taxpayers with AGI between $80,000 and $90,000 and joint filers with AGI between $160,000 and $180,000. Forty percent of the credit is refundable.

Alternative Minimum Tax The Act increases the 2009 exemption amount for calculation of the AMT to $46,700 for individuals and $70,950 for joint returns. The provision prevents approximately 24 million taxpayers from becoming subject to the AMT. This provision accounts for $70 billion of the cost of the stimulus package.

Other Individual Provisions The Act suspends taxation of certain unemployment benefits for 2009; increases the earned income tax credit for certain families for 2009 and 2010 and increases the refundable portion of the child care credit for 2009 and 2010; allows computers and computer technology to qualify as expenses under 529 plans for 2009 and 2010; equalizes the tax-free benefit payable by employers for parking and transit benefits for 2009 and 2010; and permits the deduction of sales tax paid on the first $49,500 of the purchase price of a new car, light truck, motorcycle or motor home. The sales tax deduction phases out for individual taxpayers with AGI between $125,000 and $135,000 ($250,000 and $270,000 on a joint return).

If you have questions about the American Recovery and Reinvestment Tax Act of 2009 and the impact it may have on your organization, please contact one of our **tax** attorneys:

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Grants for Energy Property in Lieu of Tax Credit Upon request by the taxpayer, the Secretary of the Treasury shall provide a grant to a taxpayer to reimburse the taxpayer for a portion of the expense of specified energy property which the taxpayer places in service. The grant funds are designed to take the place of production or investment credits that the specified energy property would otherwise qualify for. Specified energy property includes property constituting most of the facilities described in Section 45 (production credit), including wind, solar, and biomass facilities, as well as certain property described in Section 48 (investment credit), including solar, qualified fuel cell and geothermal property. The grant is restricted to specified energy property placed in service (i) during 2009 or 2010 or (ii) after 2010 (only if construction of the property began in 2009 or 2010), but before the credit termination date (which is January 1, 2013 for wind facilities eligible for the production credit; January 1, 2014 for other facilities such as biomass facilities and solar energy facilities eligible for the production credit; and January 1, 2017 for Section 48 energy property, including the 30% credit for solar panels). Taxpayers must submit a request before October 1, 2011 to be eligible for the grant.

The amount of the grant for most qualifying property, including Section 45 (production credit) property, is 30% of the property's basis. Certain Section 48 (investment credit) property is limited to a 10% credit. The amounts of the grants are not includible in the gross income of the taxpayer, but the basis of the property is reduced by fifty percent of the amount of the grant. The grants are made within 60 days after the later of the date of the grant request or the placed in service date of the property. Governments (and political subdivisions, agencies, or instrumentalities thereof), tax-exempt entities and partnerships having a partner which is a governmental or tax-exempt entity, are not eligible to receive the grant.

Properties receiving a grant are not eligible for the Section 45 credit (production) or Section 48 credit (investment) for the taxable year in which the grant is made or any subsequent year. If Section 48 (investment) credits were awarded for taxable years before a grant is made, then such credits are subject to recapture.

Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds The Act authorizes an additional $1.6 billion of clean renewable energy bonds (for a total of $2.4 billion). The Act also authorizes the issuance of $2.4 billion of additional qualified energy conservation bonds (QECBs), for a total of $3.2 billion. The Act clarifies that QECBs may be issued to make loans and grants for capital expenditures to implement green community programs.

Renewable Energy Loan Guarantees The Act provides for an additional $6 billion to pay the cost of loan guarantees authorized by the Energy Policy Act of 2005. The guarantees enable the federal government to share some of the financial risks of projects that employ new or significantly improved energy technologies that avoid, reduce, or sequester air pollutants and greenhouse gases.

New Markets Tax Credit

The Act increases the amount of New Markets Tax Credit (NMTC) allocation to $5 billion for each of 2008 and 2009. The increase in the 2008 NMTC allocation must be allocated to entities that submitted an allocation in 2008 for NMTC, but which did not receive any allocation or the full amount of the allocation request for 2008.

Significant Tax Incentives For Businesses

Extension of Bonus Depreciation The Act extends the election for bonus depreciation (immediate write-off of 50% of the cost of depreciable property) for depreciable property acquired and placed in service in 2009, and in 2010 for certain transportation or longer-lived property. The property must have a depreciable life of 20 years or less, so buildings are excluded, and the original use of the property must be with the taxpayer. The taxpayer may elect not to take bonus depreciation, for instance in cases where it has expiring net operating losses.

Extension of Section 179 Expensing The Act extends the ability of taxpayers to elect to deduct as an expense, rather than depreciate, the costs of tangible personal property used in a trade or business and placed in service in 2009. The Act increases the 179 deduction to $250,000 from $133,000. The deduction cannot exceed the taxpayer's income but may be carried forward. The amount that may be expensed is reduced by every dollar the taxpayer's capital expenditures exceeds $800,000. For example, if a taxpayer places in service $900,000 of tangible personal property used in a trade or business in 2009, the taxpayer could deduct $150,000 under this provision. Any amounts deducted under Section 179 are applied before the bonus depreciation calculation.

Carryback of Net Operating Losses Pre-Act, taxpayers were generally allowed to carryback losses two years. The Act permits losses to be carried back up to five years. The provision applies to NOLs from tax years beginning in 2008 and 2009. This provision only applies to small businesses whose gross receipts do not exceed $15,000,000.

Deferral of Cancellation of Indebtedness Income The Act permits the deferral of any income from discharge of indebtedness that results from a taxpayer's repurchase in 2009 or 2010 of an applicable debt instrument issued by the taxpayer. The deferred income is included in taxable income ratably over a five-taxable year period beginning in 2014. An applicable debt instrument is generally any contractual arrangement, bond, certificate or note constituting indebtedness. A repurchase includes an acquisition by the issuer or related party of the existing debt instrument for cash, upon the material modification of an existing debt instrument, upon an exchange of an existing debt instrument for a new debt instrument, upon the exchange of the existing debt instrument for stock or a partnership interest, upon a contribution to capital of the existing debt instrument, or upon the complete forgiveness of the existing debt instrument. Partners of partnerships or other pass-through entities electing to defer cancellation of indebtedness income will not be deemed to receive a distribution due to the reduced debt to the extent such distribution exceeds the basis of the partner's partnership interest. The deemed distribution is taken into account at the time the deferred income is recognized by the partner.

A debtor who makes the deferral may not use the exclusion for bankruptcy, insolvency, or qualified real property indebtedness for the debt discharge for the tax year of the election or later taxable year. The election for partnerships is made at the partnership level, so careful consideration must be given to the status of the partners since the exclusions described above may not be used by the partners with respect to the debt discharge from the debt instrument if the election is made. The election is irrevocable and is made on a debt-by-debt basis. The deferral is accelerated and taken into income in the taxable year in which a taxpayer dies, liquidates, sells substantially all of its assets, ceases to do business, or upon the sale or exchange of an interest in a partnership or other pass-through entity. In the case of a

bankruptcy, any deferred income is generally treated as income on the date before the bankruptcy petition is filed.

Reduction in S Corporation Built-in Gains Holding Period Under current law, a corporation may convert to an S corporation tax free; however, any built-in gains recognized during the S corporation's first ten years are subject to corporate tax. For built-in gains that otherwise would have been recognized in tax years beginning in 2009 and 2010, no built-in gain is recognized if the S corporation has been in existence (as an S corporation and not merely a corporation) for at least seven tax years prior to 2009 or 2010, respectively.

Bond Provisions

Build America Bonds A build America bond is any obligation, other than a private activity bond, if the interest on such obligation would, but for this provision, be excludable from gross income under Section 103, and such obligation is issued after February 17, 2009 and before January 1, 2011. If an issuer elects to have a bond qualify as a build America bond, then such bond becomes a taxable bond. At the election of the issuer, the Act provides for either (i) a federal tax credit to the holder of the build America bond in the amount of 35% of the interest payable to the holder by the issuer or (ii) a direct payment from the federal government to the issuer in the amount of the credits that would have been provided to the holder in item (i). The payments from the federal government to the issuer in item (ii) above are paid when the interest payments on the bonds are due, rather than as a lump sum. The interest paid to the holders of build America bonds and the credits awarded to the holders are both taxable.

Industrial Development Bonds The Act expands the definition of "manufacturing facilities" which may be financed with the proceeds of tax-exempt bonds. Manufacturing facilities now include facilities used in the creation or production of intangible property such as any patent, copyright, formula, process, design, pattern, knowhow, format or other similar item. This expanded definition applies to bonds issued in 2009 (after the effective date of the Act) and 2010.

Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds The Act authorizes $10 billion of recovery zone economic development bonds and $15 billion of recovery zone facility bonds. Recovery zones are areas designated by the issuer based upon factors such as poverty rate and unemployment rate. Each are tax credit bonds which must be issued in 2009 or 2010. The bond authority will be allocated among the states based upon each state's employment decline as compared to the national average. The states then further allocate their allocation to their counties and large municipalities based upon employment decline rates. The recovery zone economic development bonds are to be used to invest in infrastructure, public facilities, job training and educational programs. The recovery zone facility bonds are to be used to invest in property constructed, renovated or acquired by purchase and to be used in a trade or business within a recovery zone.

Tax-Exempt Interest Expense of Financial Institutions Financial institutions are not permitted to deduct the portion of their interest expense that is allocable to the tax-exempt bonds that they own. The Act modifies the formula used to calculate the portion of interest allocable to the tax-exempt bonds the financial institutions own, so that tax-exempt obligations issued in 2009 or 2010 are not taken into account. The amount of tax-exempt obligations not taken into account by reason of this new rule may not exceed two percent of the average adjusted bases for all assets of the financial institution. In addition, with respect to "qualified small issuer" bonds, the Act modifies the rule that exempts such bonds from the amount of tax-

exempt obligations in the interest disallowance calculation. The Act increases from $10,000,000 to $30,000,000, the amount of bonds that can be issued by a “qualified small issuer” in determining whether a bond issued in 2009 or 2010 qualifies for the small issuer exemption. In the case of a qualified 501(c)(3) bond issued during 2009 or 2010, the nonprofit organization for whose benefit such bond was issued will be treated as the issuer.

Tax-Exempt Interest Not Subject to AMT Tax-exempt interest on a private activity bond issued in 2009 or 2010 is not subject to the alternative minimum tax. A refunding bond is eligible for this exemption if the bond being refunded was issued in 2004 through 2008.

Qualified School Construction Bonds and Qualified Zone Academy Bonds The Act provides for the issuance of qualified school construction bonds (tax credit bonds) in the amount of $11 billion in each of 2009 and 2010. This amount is allocated among the states, with the proceeds to be used for the construction, rehabilitation, or repair of public school facilities. The national limitation for qualified zone academy bonds (tax credit bonds) is increased to $1.4 billion for each of 2009 and 2010.

Significant Individual and Family Tax Provisions

Making Work Pay Credit The Act provides a tax credit equal to 6.2% of a taxpayer’s earned income. The credit is capped at $400 for individuals and $800 for joint filers. The credit is available in 2009 and 2010 and is refundable. The credit begins phasing out for individual taxpayers with an AGI of $75,000 ($150,000 for married filing jointly) and is completely phased out for individual AGIs of $95,000 ($190,000 for married filing jointly). The credit is not considered income to recipient nor considered as a resource for purpose of determining eligibility under any federal program. This credit costs $114 billion or more than 14% of the cost of the stimulus package.

American Opportunity Work Credit The Act creates a tax credit of up to $2,500 per student per year for qualified costs for the first four years of college. The credit rate is equal to 100% of the first $2,000 of qualified expenses and 25% of the next $2,000 of expenses. The credit phases out for individual taxpayers with AGI between $80,000 and $90,000 and joint filers with AGI between $160,000 and $180,000. Forty percent of the credit is refundable.

Alternative Minimum Tax The Act increases the 2009 exemption amount for calculation of the AMT to $46,700 for individuals and $70,950 for joint returns. The provision prevents approximately 24 million taxpayers from becoming subject to the AMT. This provision accounts for $70 billion of the cost of the stimulus package.

Other Individual Provisions The Act suspends taxation of certain unemployment benefits for 2009; increases the earned income tax credit for certain families for 2009 and 2010 and increases the refundable portion of the child care credit for 2009 and 2010; allows computers and computer technology to qualify as expenses under 529 plans for 2009 and 2010; equalizes the tax-free benefit payable by employers for parking and transit benefits for 2009 and 2010; and permits the deduction of sales tax paid on the first $49,500 of the purchase price of a new car, light truck, motorcycle or motor home. The sales tax deduction phases out for individual taxpayers with AGI between $125,000 and $135,000 ($250,000 and $270,000 on a joint return).

If you have questions about the American Recovery and Reinvestment Tax Act of 2009 and the impact it may have on your organization, please contact one of our **tax** attorneys:

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CLIENT ALERT

February 2009

The American Recovery and Reinvestment Tax Act of 2009

On February 17, 2009, President Barack Obama signed into law the economic stimulus package entitled the American Recovery and Reinvestment Tax Act of 2009 (the Act). The cost of the Act is $787 billion and consists of (1) $287 billion in tax breaks, the vast majority of which are tax cuts or credits for low and middle income workers; (2) $192 billion in direct aid to states and individuals to increase Medicaid payments, jobless benefits and health care programs; and (3) $308 billion in discretionary spending for education, infrastructure, energy, and health and science research. This Client Alert, prepared by Gallagher's tax lawyers, highlights many of the important provisions of the Act in the areas of low-income and affordable housing, renewable energy, bonds and small business and individual tax breaks.

LIHTC and Affordable Housing Provisions

LIHTC Monetization Program The monetization program permits state tax credit allocating agencies (SAAs) to return to the U.S. Treasury (i) any unused housing tax credit ceiling for 2008, plus (ii) any low income housing tax credits (LIHTCs) returned in 2009 from prior years' allocations, plus (iii) 40% of the state's 2009 allocation, plus (iv) 40% of the state's share of the national pool of LIHTCs allocated in 2009. In return, the SAAs receive cash equal to 85% of the ten year credit amount for the returned LIHTCs. For example, if the State of Maryland has $11 million of LIHTCs to allocate in 2009, it could elect to transfer up to 40% of this amount or $4.4 million to the Treasury and receive a grant of $37.4 million from the Treasury. The State of Maryland would then have $6.6 million of LIHTCs to allocate in 2009.

The SAAs can use these monies to make subawards to projects to finance the construction, acquisition or rehabilitation of low-income buildings as defined under the LIHTC program. These awards may be made to a project regardless of whether the project has or will receive an allocation of LIHTCs. In making a subaward, the SAA is required to make the determination that the subaward to the project will increase the total funds available to the state to build and rehabilitate affordable housing. In conjunction with this determination, the SAA must establish a process in which subaward candidates demonstrate good faith efforts to obtain a traditional equity commitment from a LIHTC investor before the SAA makes the subaward. The subaward is made in the same competitive manner as the allocation of the LIHTCs, and requires compliance with rent, income and use restrictions for the building to be financed. The SAA is empowered to ensure compliance with Section 42. The failure of the project to comply with Section 42 will result in recapture of the grant by means of a lien or other method approved by Treasury. Any funds not awarded by an SAA by December 31, 2010, must be returned to Treasury. According to the Act's joint committee report, grants made by the SAAs under this program are not taxable to the recipients, however this language is not in the Act. The Act does provide that the basis of the building is not reduced by receipt of the grant.

Further guidance from the IRS and the SAAs will be required to understand how the program will be implemented. For instance, how will SAAs determine if the subaward would increase the total funds available to the state for affordable housing? Will the SAA take into account a commitment of equity at any level or only at or above $.85 in determining total funds available to the state for affordable housing and in determining a good faith effort to obtain an investor? Once subawards are made, how will SAAs fund the subawards, upfront or on a schedule similar to equity contributions? What is the process for returning past years' credits? Will projects with 2008 allocations and equity commitments (that are not yet closed) simply be able to turn in their allocations for a subaward? Under what circumstances would the subaward become repayable, and will the repayment provisions be similar to the LIHTC recapture provisions? How will SAAs asset manage and enforce compliance with Section 42? Many of the answers to these questions will require revisions to state qualified allocation plans and procedures.

HOME FUNDS (Gap Financing) HUD will provide an additional $2.25 billion in HOME funds to SAAs for only LIHTC projects based upon the 2008 HOME apportionment formula. The SAAs must award the HOME Funds no later than September 30, 2009. The funds will remain available through September 30, 2011. The SAAs are required to distribute the funds competitively pursuant to their qualified allocation plans to owners of LIHTC projects that have received or receive simultaneously with the HOME funds an award of LIHTCs. The term "award" is not defined by the Act. Further guidance is required as to whether an award is defined as an allocation of LIHTCs, or simply a reservation of LIHTCs. Further guidance will also be required as to when LIHTCs are awarded for projects qualifying for LIHTCs with tax-exempt bonds. It is also unclear if these funds may be used in deals where LIHTCs have previously been awarded but have been returned under the monetization program described above.

The SAAs are required to commit at least 75% of the funds within one year of the Act's enactment and project owners must expend 75% of the funds within two years, and 100% within three years. The funds may be used for projects receiving an award of LIHTCs within the 2007, 2008 or 2009 fiscal years. SAAs are required to give priority to projects that are expected to be completed within three years of enactment. The award of HOME funds is required to be made in the same manner and subject to the same limitations (including income, rent and use restrictions) as required by the SAAs with respect to the award of LIHTCs. The eligible basis of a project is not reduced by a grant of these funds, however, a grant of funds would result in income to the project owner.

Other Affordable Housing Provisions:

Public Housing Capital Fund The Act provides $4 billion in public housing capital funds of which $3 billion will be distributed by formula and $1 billion will be distributed based on a competitive process for priority investments, including investments that leverage private sector financing and energy conservation retrofits. Priority will be given to public housing projects underway, those that can award contracts within 120 days and those included in five year capital fund plans. One hundred percent of the funds must be obligated within one year of the funds becoming available to public housing agencies, 60% must be expended within two years of the date funds become available to the public housing agencies and 100% within three years. These funds may not be used for operating or rental subsidies.

Project Based Rental Assistance The Act provides $2.25 billion for additional project based rental assistance for Section 8, Section 202, and Section 811 programs of which $250 million are to be used for grants or loans to energy retrofit or make green

investments in projects. Owners must commit to an additional period of affordability of not less than 15 years for grants or loans provided under the $250 million retrofit/green investments program.

Homelessness Prevention Fund The Act provides $1.5 billion through September 30, 2011, for homelessness prevention. Grants will be distributed to governments based on the emergency shelter grant formula.

Home Purchase Credit Prior to the Act, eligible first time homebuyers could claim a refundable tax credit equal to the lesser of 10% of the purchase price of the principal residence and $7,500. The credit was then recaptured over 15 years with no interest charged. With the recapture, the credit amounted to a zero percent loan. The Act, for purchases on or after January 1, 2009 and before December 1, 2009, generally waives recapture unless the taxpayer disposes of the home or the home otherwise ceases to be the taxpayer's principal residence within 36 months from the date of purchase. The Act also increases the credit to $8,000. The credit phases out for individuals with adjusted gross income (AGI) between $75,000 and $95,000 ($150,000 to $190,000 for joint filers).

Lead Hazard Prevention Program The Act provides $100 million for additional funds under the Lead Hazard Prevention Program.

Community Development Block Grant Program The Act provides for an additional $1 billion to remain available until September 30, 2010, to carry out the Community Development Block Grant Program.

Renewable Energy Provisions

Extension of Renewable Energy Production Credits The placed in service date has been extended for three years for certain facilities qualifying for the renewable energy production credit described in Section 45. The placed in service deadline for wind facilities is now December 31, 2012. The placed in service deadline for the following other facilities is now December 31, 2013: closed-loop biomass facilities, open-loop biomass facilities, geothermal or solar energy facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic renewable energy facilities.

Election of Investment Credit in Lieu of Production Credit Under Section 45, owners of certain energy-producing facilities (see previous paragraph) may earn an annual tax credit based upon the facility's energy production. Under Section 48, certain energy property may earn a 30% investment tax credit in the year the facility is placed in service (based upon the basis of the property placed in service). The Act permits a taxpayer to make an irrevocable election to have any of the production credit facilities listed in the paragraph above earn the 30% investment tax credit under Section 48 in lieu of the Section 45 production credit. A taxpayer may not earn credits under both Section 48 and Section 45. The provision applies to facilities placed in service after December 31, 2008 and before the applicable Section 45 production credit deadline, extended by the Act, as described in the paragraph above.

No Reduction of Investment Tax Credit Section 48 energy property, including solar-related energy property, which is financed with (i) subsidies from a Federal, State or local program or (ii) the proceeds of tax-exempt private activity bonds, is no longer subject to a basis

reduction in calculating the 30% investment tax credit. This provision applies to basis attributable to construction performed after December 31, 2008.

Grants for Energy Property in Lieu of Tax Credit Upon request by the taxpayer, the Secretary of the Treasury shall provide a grant to a taxpayer to reimburse the taxpayer for a portion of the expense of specified energy property which the taxpayer places in service. The grant funds are designed to take the place of production or investment credits that the specified energy property would otherwise qualify for. Specified energy property includes property constituting most of the facilities described in Section 45 (production credit), including wind, solar, and biomass facilities, as well as certain property described in Section 48 (investment credit), including solar, qualified fuel cell and geothermal property. The grant is restricted to specified energy property placed in service (i) during 2009 or 2010 or (ii) after 2010 (only if construction of the property began in 2009 or 2010), but before the credit termination date (which is January 1, 2013 for wind facilities eligible for the production credit; January 1, 2014 for other facilities such as biomass facilities and solar energy facilities eligible for the production credit; and January 1, 2017 for Section 48 energy property, including the 30% credit for solar panels). Taxpayers must submit a request before October 1, 2011 to be eligible for the grant.

The amount of the grant for most qualifying property, including Section 45 (production credit) property, is 30% of the property's basis. Certain Section 48 (investment credit) property is limited to a 10% credit. The amounts of the grants are not includible in the gross income of the taxpayer, but the basis of the property is reduced by fifty percent of the amount of the grant. The grants are made within 60 days after the later of the date of the grant request or the placed in service date of the property. Governments (and political subdivisions, agencies, or instrumentalities thereof), tax-exempt entities and partnerships having a partner which is a governmental or tax-exempt entity, are not eligible to receive the grant.

Properties receiving a grant are not eligible for the Section 45 credit (production) or Section 48 credit (investment) for the taxable year in which the grant is made or any subsequent year. If Section 48 (investment) credits were awarded for taxable years before a grant is made, then such credits are subject to recapture.

Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds The Act authorizes an additional $1.6 billion of clean renewable energy bonds (for a total of $2.4 billion). The Act also authorizes the issuance of $2.4 billion of additional qualified energy conservation bonds (QECBs), for a total of $3.2 billion. The Act clarifies that QECBs may be issued to make loans and grants for capital expenditures to implement green community programs.

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Tax-Exempt Interest Expense of Financial Institutions Financial institutions are not permitted to deduct the portion of their interest expense that is allocable to the tax-exempt bonds that they own. The Act modifies the formula used to calculate the portion of interest allocable to the tax-exempt bonds the financial institutions own, so that tax-exempt obligations issued in 2009 or 2010 are not taken into account. The amount of tax-exempt obligations not taken into account by reason of this new rule may not exceed two percent of the average adjusted bases for all assets of the financial institution. In addition, with respect to "qualified small issuer" bonds, the Act modifies the rule that exempts such bonds from the amount of tax-

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Making Work Pay Credit The Act provides a tax credit equal to 6.2% of a taxpayer’s earned income. The credit is capped at $400 for individuals and $800 for joint filers. The credit is available in 2009 and 2010 and is refundable. The credit begins phasing out for individual taxpayers with an AGI of $75,000 ($150,000 for married filing jointly) and is completely phased out for individual AGIs of $95,000 ($190,000 for married filing jointly). The credit is not considered income to recipient nor considered as a resource for purpose of determining eligibility under any federal program. This credit costs $114 billion or more than 14% of the cost of the stimulus package.

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CLIENT ALERT

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LIHTC and Affordable Housing Provisions

LIHTC Monetization Program The monetization program permits state tax credit allocating agencies (SAAs) to return to the U.S. Treasury (i) any unused housing tax credit ceiling for 2008, plus (ii) any low income housing tax credits (LIHTCs) returned in 2009 from prior years' allocations, plus (iii) 40% of the state's 2009 allocation, plus (iv) 40% of the state's share of the national pool of LIHTCs allocated in 2009. In return, the SAAs receive cash equal to 85% of the ten year credit amount for the returned LIHTCs. For example, if the State of Maryland has $11 million of LIHTCs to allocate in 2009, it could elect to transfer up to 40% of this amount or $4.4 million to the Treasury and receive a grant of $37.4 million from the Treasury. The State of Maryland would then have $6.6 million of LIHTCs to allocate in 2009.

The SAAs can use these monies to make subawards to projects to finance the construction, acquisition or rehabilitation of low-income buildings as defined under the LIHTC program. These awards may be made to a project regardless of whether the project has or will receive an allocation of LIHTCs. In making a subaward, the SAA is required to make the determination that the subaward to the project will increase the total funds available to the state to build and rehabilitate affordable housing. In conjunction with this determination, the SAA must establish a process in which subaward candidates demonstrate good faith efforts to obtain a traditional equity commitment from a LIHTC investor before the SAA makes the subaward. The subaward is made in the same competitive manner as the allocation of the LIHTCs, and requires compliance with rent, income and use restrictions for the building to be financed. The SAA is empowered to ensure compliance with Section 42. The failure of the project to comply with Section 42 will result in recapture of the grant by means of a lien or other method approved by Treasury. Any funds not awarded by an SAA by December 31, 2010, must be returned to Treasury. According to the Act's joint committee report, grants made by the SAAs under this program are not taxable to the recipients, however this language is not in the Act. The Act does provide that the basis of the building is not reduced by receipt of the grant.

Further guidance from the IRS and the SAAs will be required to understand how the program will be implemented. For instance, how will SAAs determine if the subaward would increase the total funds available to the state for affordable housing? Will the SAA take into account a commitment of equity at any level or only at or above $.85 in determining total funds available to the state for affordable housing and in determining a good faith effort to obtain an investor? Once subawards are made, how will SAAs fund the subawards, upfront or on a schedule similar to equity contributions? What is the process for returning past years' credits? Will projects with 2008 allocations and equity commitments (that are not yet closed) simply be able to turn in their allocations for a subaward? Under what circumstances would the subaward become repayable, and will the repayment provisions be similar to the LIHTC recapture provisions? How will SAAs asset manage and enforce compliance with Section 42? Many of the answers to these questions will require revisions to state qualified allocation plans and procedures.

HOME FUNDS (Gap Financing) HUD will provide an additional $2.25 billion in HOME funds to SAAs for only LIHTC projects based upon the 2008 HOME apportionment formula. The SAAs must award the HOME Funds no later than September 30, 2009. The funds will remain available through September 30, 2011. The SAAs are required to distribute the funds competitively pursuant to their qualified allocation plans to owners of LIHTC projects that have received or receive simultaneously with the HOME funds an award of LIHTCs. The term "award" is not defined by the Act. Further guidance is required as to whether an award is defined as an allocation of LIHTCs, or simply a reservation of LIHTCs. Further guidance will also be required as to when LIHTCs are awarded for projects qualifying for LIHTCs with tax-exempt bonds. It is also unclear if these funds may be used in deals where LIHTCs have previously been awarded but have been returned under the monetization program described above.

The SAAs are required to commit at least 75% of the funds within one year of the Act's enactment and project owners must expend 75% of the funds within two years, and 100% within three years. The funds may be used for projects receiving an award of LIHTCs within the 2007, 2008 or 2009 fiscal years. SAAs are required to give priority to projects that are expected to be completed within three years of enactment. The award of HOME funds is required to be made in the same manner and subject to the same limitations (including income, rent and use restrictions) as required by the SAAs with respect to the award of LIHTCs. The eligible basis of a project is not reduced by a grant of these funds, however, a grant of funds would result in income to the project owner.

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Public Housing Capital Fund The Act provides $4 billion in public housing capital funds of which $3 billion will be distributed by formula and $1 billion will be distributed based on a competitive process for priority investments, including investments that leverage private sector financing and energy conservation retrofits. Priority will be given to public housing projects underway, those that can award contracts within 120 days and those included in five year capital fund plans. One hundred percent of the funds must be obligated within one year of the funds becoming available to public housing agencies, 60% must be expended within two years of the date funds become available to the public housing agencies and 100% within three years. These funds may not be used for operating or rental subsidies.

Project Based Rental Assistance The Act provides $2.25 billion for additional project based rental assistance for Section 8, Section 202, and Section 811 programs of which $250 million are to be used for grants or loans to energy retrofit or make green

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Lead Hazard Prevention Program The Act provides $100 million for additional funds under the Lead Hazard Prevention Program.

Community Development Block Grant Program The Act provides for an additional $1 billion to remain available until September 30, 2010, to carry out the Community Development Block Grant Program.

Renewable Energy Provisions

Extension of Renewable Energy Production Credits The placed in service date has been extended for three years for certain facilities qualifying for the renewable energy production credit described in Section 45. The placed in service deadline for wind facilities is now December 31, 2012. The placed in service deadline for the following other facilities is now December 31, 2013: closed-loop biomass facilities, open-loop biomass facilities, geothermal or solar energy facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic renewable energy facilities.

Election of Investment Credit in Lieu of Production Credit Under Section 45, owners of certain energy-producing facilities (see previous paragraph) may earn an annual tax credit based upon the facility's energy production. Under Section 48, certain energy property may earn a 30% investment tax credit in the year the facility is placed in service (based upon the basis of the property placed in service). The Act permits a taxpayer to make an irrevocable election to have any of the production credit facilities listed in the paragraph above earn the 30% investment tax credit under Section 48 in lieu of the Section 45 production credit. A taxpayer may not earn credits under both Section 48 and Section 45. The provision applies to facilities placed in service after December 31, 2008 and before the applicable Section 45 production credit deadline, extended by the Act, as described in the paragraph above.

No Reduction of Investment Tax Credit Section 48 energy property, including solar-related energy property, which is financed with (i) subsidies from a Federal, State or local program or (ii) the proceeds of tax-exempt private activity bonds, is no longer subject to a basis

reduction in calculating the 30% investment tax credit. This provision applies to basis attributable to construction performed after December 31, 2008.

Grants for Energy Property in Lieu of Tax Credit Upon request by the taxpayer, the Secretary of the Treasury shall provide a grant to a taxpayer to reimburse the taxpayer for a portion of the expense of specified energy property which the taxpayer places in service. The grant funds are designed to take the place of production or investment credits that the specified energy property would otherwise qualify for. Specified energy property includes property constituting most of the facilities described in Section 45 (production credit), including wind, solar, and biomass facilities, as well as certain property described in Section 48 (investment credit), including solar, qualified fuel cell and geothermal property. The grant is restricted to specified energy property placed in service (i) during 2009 or 2010 or (ii) after 2010 (only if construction of the property began in 2009 or 2010), but before the credit termination date (which is January 1, 2013 for wind facilities eligible for the production credit; January 1, 2014 for other facilities such as biomass facilities and solar energy facilities eligible for the production credit; and January 1, 2017 for Section 48 energy property, including the 30% credit for solar panels). Taxpayers must submit a request before October 1, 2011 to be eligible for the grant.

The amount of the grant for most qualifying property, including Section 45 (production credit) property, is 30% of the property's basis. Certain Section 48 (investment credit) property is limited to a 10% credit. The amounts of the grants are not includible in the gross income of the taxpayer, but the basis of the property is reduced by fifty percent of the amount of the grant. The grants are made within 60 days after the later of the date of the grant request or the placed in service date of the property. Governments (and political subdivisions, agencies, or instrumentalities thereof), tax-exempt entities and partnerships having a partner which is a governmental or tax-exempt entity, are not eligible to receive the grant.

Properties receiving a grant are not eligible for the Section 45 credit (production) or Section 48 credit (investment) for the taxable year in which the grant is made or any subsequent year. If Section 48 (investment) credits were awarded for taxable years before a grant is made, then such credits are subject to recapture.

Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds The Act authorizes an additional $1.6 billion of clean renewable energy bonds (for a total of $2.4 billion). The Act also authorizes the issuance of $2.4 billion of additional qualified energy conservation bonds (QECBs), for a total of $3.2 billion. The Act clarifies that QECBs may be issued to make loans and grants for capital expenditures to implement green community programs.

Renewable Energy Loan Guarantees The Act provides for an additional $6 billion to pay the cost of loan guarantees authorized by the Energy Policy Act of 2005. The guarantees enable the federal government to share some of the financial risks of projects that employ new or significantly improved energy technologies that avoid, reduce, or sequester air pollutants and greenhouse gases.

New Markets Tax Credit

The Act increases the amount of New Markets Tax Credit (NMTC) allocation to $5 billion for each of 2008 and 2009. The increase in the 2008 NMTC allocation must be allocated to entities that submitted an allocation in 2008 for NMTC, but which did not receive any allocation or the full amount of the allocation request for 2008.

Significant Tax Incentives For Businesses

Extension of Bonus Depreciation The Act extends the election for bonus depreciation (immediate write-off of 50% of the cost of depreciable property) for depreciable property acquired and placed in service in 2009, and in 2010 for certain transportation or longer-lived property. The property must have a depreciable life of 20 years or less, so buildings are excluded, and the original use of the property must be with the taxpayer. The taxpayer may elect not to take bonus depreciation, for instance in cases where it has expiring net operating losses.

Extension of Section 179 Expensing The Act extends the ability of taxpayers to elect to deduct as an expense, rather than depreciate, the costs of tangible personal property used in a trade or business and placed in service in 2009. The Act increases the 179 deduction to $250,000 from $133,000. The deduction cannot exceed the taxpayer's income but may be carried forward. The amount that may be expensed is reduced by every dollar the taxpayer's capital expenditures exceeds $800,000. For example, if a taxpayer places in service $900,000 of tangible personal property used in a trade or business in 2009, the taxpayer could deduct $150,000 under this provision. Any amounts deducted under Section 179 are applied before the bonus depreciation calculation.

Carryback of Net Operating Losses Pre-Act, taxpayers were generally allowed to carryback losses two years. The Act permits losses to be carried back up to five years. The provision applies to NOLs from tax years beginning in 2008 and 2009. This provision only applies to small businesses whose gross receipts do not exceed $15,000,000.

Deferral of Cancellation of Indebtedness Income The Act permits the deferral of any income from discharge of indebtedness that results from a taxpayer's repurchase in 2009 or 2010 of an applicable debt instrument issued by the taxpayer. The deferred income is included in taxable income ratably over a five-taxable year period beginning in 2014. An applicable debt instrument is generally any contractual arrangement, bond, certificate or note constituting indebtedness. A repurchase includes an acquisition by the issuer or related party of the existing debt instrument for cash, upon the material modification of an existing debt instrument, upon an exchange of an existing debt instrument for a new debt instrument, upon the exchange of the existing debt instrument for stock or a partnership interest, upon a contribution to capital of the existing debt instrument, or upon the complete forgiveness of the existing debt instrument. Partners of partnerships or other pass-through entities electing to defer cancellation of indebtedness income will not be deemed to receive a distribution due to the reduced debt to the extent such distribution exceeds the basis of the partner's partnership interest. The deemed distribution is taken into account at the time the deferred income is recognized by the partner.

A debtor who makes the deferral may not use the exclusion for bankruptcy, insolvency, or qualified real property indebtedness for the debt discharge for the tax year of the election or later taxable year. The election for partnerships is made at the partnership level, so careful consideration must be given to the status of the partners since the exclusions described above may not be used by the partners with respect to the debt discharge from the debt instrument if the election is made. The election is irrevocable and is made on a debt-by-debt basis. The deferral is accelerated and taken into income in the taxable year in which a taxpayer dies, liquidates, sells substantially all of its assets, ceases to do business, or upon the sale or exchange of an interest in a partnership or other pass-through entity. In the case of a

bankruptcy, any deferred income is generally treated as income on the date before the bankruptcy petition is filed.

Reduction in S Corporation Built-in Gains Holding Period Under current law, a corporation may convert to an S corporation tax free; however, any built-in gains recognized during the S corporation's first ten years are subject to corporate tax. For built-in gains that otherwise would have been recognized in tax years beginning in 2009 and 2010, no built-in gain is recognized if the S corporation has been in existence (as an S corporation and not merely a corporation) for at least seven tax years prior to 2009 or 2010, respectively.

Bond Provisions

Build America Bonds A build America bond is any obligation, other than a private activity bond, if the interest on such obligation would, but for this provision, be excludable from gross income under Section 103, and such obligation is issued after February 17, 2009 and before January 1, 2011. If an issuer elects to have a bond qualify as a build America bond, then such bond becomes a taxable bond. At the election of the issuer, the Act provides for either (i) a federal tax credit to the holder of the build America bond in the amount of 35% of the interest payable to the holder by the issuer or (ii) a direct payment from the federal government to the issuer in the amount of the credits that would have been provided to the holder in item (i). The payments from the federal government to the issuer in item (ii) above are paid when the interest payments on the bonds are due, rather than as a lump sum. The interest paid to the holders of build America bonds and the credits awarded to the holders are both taxable.

Industrial Development Bonds The Act expands the definition of "manufacturing facilities" which may be financed with the proceeds of tax-exempt bonds. Manufacturing facilities now include facilities used in the creation or production of intangible property such as any patent, copyright, formula, process, design, pattern, knowhow, format or other similar item. This expanded definition applies to bonds issued in 2009 (after the effective date of the Act) and 2010.

Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds The Act authorizes $10 billion of recovery zone economic development bonds and $15 billion of recovery zone facility bonds. Recovery zones are areas designated by the issuer based upon factors such as poverty rate and unemployment rate. Each are tax credit bonds which must be issued in 2009 or 2010. The bond authority will be allocated among the states based upon each state's employment decline as compared to the national average. The states then further allocate their allocation to their counties and large municipalities based upon employment decline rates. The recovery zone economic development bonds are to be used to invest in infrastructure, public facilities, job training and educational programs. The recovery zone facility bonds are to be used to invest in property constructed, renovated or acquired by purchase and to be used in a trade or business within a recovery zone.

Tax-Exempt Interest Expense of Financial Institutions Financial institutions are not permitted to deduct the portion of their interest expense that is allocable to the tax-exempt bonds that they own. The Act modifies the formula used to calculate the portion of interest allocable to the tax-exempt bonds the financial institutions own, so that tax-exempt obligations issued in 2009 or 2010 are not taken into account. The amount of tax-exempt obligations not taken into account by reason of this new rule may not exceed two percent of the average adjusted bases for all assets of the financial institution. In addition, with respect to "qualified small issuer" bonds, the Act modifies the rule that exempts such bonds from the amount of tax-

exempt obligations in the interest disallowance calculation. The Act increases from $10,000,000 to $30,000,000, the amount of bonds that can be issued by a “qualified small issuer” in determining whether a bond issued in 2009 or 2010 qualifies for the small issuer exemption. In the case of a qualified 501(c)(3) bond issued during 2009 or 2010, the nonprofit organization for whose benefit such bond was issued will be treated as the issuer.

Tax-Exempt Interest Not Subject to AMT Tax-exempt interest on a private activity bond issued in 2009 or 2010 is not subject to the alternative minimum tax. A refunding bond is eligible for this exemption if the bond being refunded was issued in 2004 through 2008.

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Homelessness Prevention Fund The Act provides $1.5 billion through September 30, 2011, for homelessness prevention. Grants will be distributed to governments based on the emergency shelter grant formula.

Home Purchase Credit Prior to the Act, eligible first time homebuyers could claim a refundable tax credit equal to the lesser of 10% of the purchase price of the principal residence and $7,500. The credit was then recaptured over 15 years with no interest charged. With the recapture, the credit amounted to a zero percent loan. The Act, for purchases on or after January 1, 2009 and before December 1, 2009, generally waives recapture unless the taxpayer disposes of the home or the home otherwise ceases to be the taxpayer's principal residence within 36 months from the date of purchase. The Act also increases the credit to $8,000. The credit phases out for individuals with adjusted gross income (AGI) between $75,000 and $95,000 ($150,000 to $190,000 for joint filers).

Lead Hazard Prevention Program The Act provides $100 million for additional funds under the Lead Hazard Prevention Program.

Community Development Block Grant Program The Act provides for an additional $1 billion to remain available until September 30, 2010, to carry out the Community Development Block Grant Program.

Renewable Energy Provisions

Extension of Renewable Energy Production Credits The placed in service date has been extended for three years for certain facilities qualifying for the renewable energy production credit described in Section 45. The placed in service deadline for wind facilities is now December 31, 2012. The placed in service deadline for the following other facilities is now December 31, 2013: closed-loop biomass facilities, open-loop biomass facilities, geothermal or solar energy facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic renewable energy facilities.

Election of Investment Credit in Lieu of Production Credit Under Section 45, owners of certain energy-producing facilities (see previous paragraph) may earn an annual tax credit based upon the facility's energy production. Under Section 48, certain energy property may earn a 30% investment tax credit in the year the facility is placed in service (based upon the basis of the property placed in service). The Act permits a taxpayer to make an irrevocable election to have any of the production credit facilities listed in the paragraph above earn the 30% investment tax credit under Section 48 in lieu of the Section 45 production credit. A taxpayer may not earn credits under both Section 48 and Section 45. The provision applies to facilities placed in service after December 31, 2008 and before the applicable Section 45 production credit deadline, extended by the Act, as described in the paragraph above.

No Reduction of Investment Tax Credit Section 48 energy property, including solar-related energy property, which is financed with (i) subsidies from a Federal, State or local program or (ii) the proceeds of tax-exempt private activity bonds, is no longer subject to a basis

reduction in calculating the 30% investment tax credit. This provision applies to basis attributable to construction performed after December 31, 2008.

Grants for Energy Property in Lieu of Tax Credit Upon request by the taxpayer, the Secretary of the Treasury shall provide a grant to a taxpayer to reimburse the taxpayer for a portion of the expense of specified energy property which the taxpayer places in service. The grant funds are designed to take the place of production or investment credits that the specified energy property would otherwise qualify for. Specified energy property includes property constituting most of the facilities described in Section 45 (production credit), including wind, solar, and biomass facilities, as well as certain property described in Section 48 (investment credit), including solar, qualified fuel cell and geothermal property. The grant is restricted to specified energy property placed in service (i) during 2009 or 2010 or (ii) after 2010 (only if construction of the property began in 2009 or 2010), but before the credit termination date (which is January 1, 2013 for wind facilities eligible for the production credit; January 1, 2014 for other facilities such as biomass facilities and solar energy facilities eligible for the production credit; and January 1, 2017 for Section 48 energy property, including the 30% credit for solar panels). Taxpayers must submit a request before October 1, 2011 to be eligible for the grant.

The amount of the grant for most qualifying property, including Section 45 (production credit) property, is 30% of the property's basis. Certain Section 48 (investment credit) property is limited to a 10% credit. The amounts of the grants are not includible in the gross income of the taxpayer, but the basis of the property is reduced by fifty percent of the amount of the grant. The grants are made within 60 days after the later of the date of the grant request or the placed in service date of the property. Governments (and political subdivisions, agencies, or instrumentalities thereof), tax-exempt entities and partnerships having a partner which is a governmental or tax-exempt entity, are not eligible to receive the grant.

Properties receiving a grant are not eligible for the Section 45 credit (production) or Section 48 credit (investment) for the taxable year in which the grant is made or any subsequent year. If Section 48 (investment) credits were awarded for taxable years before a grant is made, then such credits are subject to recapture.

Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds The Act authorizes an additional $1.6 billion of clean renewable energy bonds (for a total of $2.4 billion). The Act also authorizes the issuance of $2.4 billion of additional qualified energy conservation bonds (QECBs), for a total of $3.2 billion. The Act clarifies that QECBs may be issued to make loans and grants for capital expenditures to implement green community programs.

Renewable Energy Loan Guarantees The Act provides for an additional $6 billion to pay the cost of loan guarantees authorized by the Energy Policy Act of 2005. The guarantees enable the federal government to share some of the financial risks of projects that employ new or significantly improved energy technologies that avoid, reduce, or sequester air pollutants and greenhouse gases.

New Markets Tax Credit

The Act increases the amount of New Markets Tax Credit (NMTC) allocation to $5 billion for each of 2008 and 2009. The increase in the 2008 NMTC allocation must be allocated to entities that submitted an allocation in 2008 for NMTC, but which did not receive any allocation or the full amount of the allocation request for 2008.

Significant Tax Incentives For Businesses

Extension of Bonus Depreciation The Act extends the election for bonus depreciation (immediate write-off of 50% of the cost of depreciable property) for depreciable property acquired and placed in service in 2009, and in 2010 for certain transportation or longer-lived property. The property must have a depreciable life of 20 years or less, so buildings are excluded, and the original use of the property must be with the taxpayer. The taxpayer may elect not to take bonus depreciation, for instance in cases where it has expiring net operating losses.

Extension of Section 179 Expensing The Act extends the ability of taxpayers to elect to deduct as an expense, rather than depreciate, the costs of tangible personal property used in a trade or business and placed in service in 2009. The Act increases the 179 deduction to $250,000 from $133,000. The deduction cannot exceed the taxpayer's income but may be carried forward. The amount that may be expensed is reduced by every dollar the taxpayer's capital expenditures exceeds $800,000. For example, if a taxpayer places in service $900,000 of tangible personal property used in a trade or business in 2009, the taxpayer could deduct $150,000 under this provision. Any amounts deducted under Section 179 are applied before the bonus depreciation calculation.

Carryback of Net Operating Losses Pre-Act, taxpayers were generally allowed to carryback losses two years. The Act permits losses to be carried back up to five years. The provision applies to NOLs from tax years beginning in 2008 and 2009. This provision only applies to small businesses whose gross receipts do not exceed $15,000,000.

Deferral of Cancellation of Indebtedness Income The Act permits the deferral of any income from discharge of indebtedness that results from a taxpayer's repurchase in 2009 or 2010 of an applicable debt instrument issued by the taxpayer. The deferred income is included in taxable income ratably over a five-taxable year period beginning in 2014. An applicable debt instrument is generally any contractual arrangement, bond, certificate or note constituting indebtedness. A repurchase includes an acquisition by the issuer or related party of the existing debt instrument for cash, upon the material modification of an existing debt instrument, upon an exchange of an existing debt instrument for a new debt instrument, upon the exchange of the existing debt instrument for stock or a partnership interest, upon a contribution to capital of the existing debt instrument, or upon the complete forgiveness of the existing debt instrument. Partners of partnerships or other pass-through entities electing to defer cancellation of indebtedness income will not be deemed to receive a distribution due to the reduced debt to the extent such distribution exceeds the basis of the partner's partnership interest. The deemed distribution is taken into account at the time the deferred income is recognized by the partner.

A debtor who makes the deferral may not use the exclusion for bankruptcy, insolvency, or qualified real property indebtedness for the debt discharge for the tax year of the election or later taxable year. The election for partnerships is made at the partnership level, so careful consideration must be given to the status of the partners since the exclusions described above may not be used by the partners with respect to the debt discharge from the debt instrument if the election is made. The election is irrevocable and is made on a debt-by-debt basis. The deferral is accelerated and taken into income in the taxable year in which a taxpayer dies, liquidates, sells substantially all of its assets, ceases to do business, or upon the sale or exchange of an interest in a partnership or other pass-through entity. In the case of a

bankruptcy, any deferred income is generally treated as income on the date before the bankruptcy petition is filed.

Reduction in S Corporation Built-in Gains Holding Period Under current law, a corporation may convert to an S corporation tax free; however, any built-in gains recognized during the S corporation's first ten years are subject to corporate tax. For built-in gains that otherwise would have been recognized in tax years beginning in 2009 and 2010, no built-in gain is recognized if the S corporation has been in existence (as an S corporation and not merely a corporation) for at least seven tax years prior to 2009 or 2010, respectively.

Bond Provisions

Build America Bonds A build America bond is any obligation, other than a private activity bond, if the interest on such obligation would, but for this provision, be excludable from gross income under Section 103, and such obligation is issued after February 17, 2009 and before January 1, 2011. If an issuer elects to have a bond qualify as a build America bond, then such bond becomes a taxable bond. At the election of the issuer, the Act provides for either (i) a federal tax credit to the holder of the build America bond in the amount of 35% of the interest payable to the holder by the issuer or (ii) a direct payment from the federal government to the issuer in the amount of the credits that would have been provided to the holder in item (i). The payments from the federal government to the issuer in item (ii) above are paid when the interest payments on the bonds are due, rather than as a lump sum. The interest paid to the holders of build America bonds and the credits awarded to the holders are both taxable.

Industrial Development Bonds The Act expands the definition of "manufacturing facilities" which may be financed with the proceeds of tax-exempt bonds. Manufacturing facilities now include facilities used in the creation or production of intangible property such as any patent, copyright, formula, process, design, pattern, knowhow, format or other similar item. This expanded definition applies to bonds issued in 2009 (after the effective date of the Act) and 2010.

Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds The Act authorizes $10 billion of recovery zone economic development bonds and $15 billion of recovery zone facility bonds. Recovery zones are areas designated by the issuer based upon factors such as poverty rate and unemployment rate. Each are tax credit bonds which must be issued in 2009 or 2010. The bond authority will be allocated among the states based upon each state's employment decline as compared to the national average. The states then further allocate their allocation to their counties and large municipalities based upon employment decline rates. The recovery zone economic development bonds are to be used to invest in infrastructure, public facilities, job training and educational programs. The recovery zone facility bonds are to be used to invest in property constructed, renovated or acquired by purchase and to be used in a trade or business within a recovery zone.

Tax-Exempt Interest Expense of Financial Institutions Financial institutions are not permitted to deduct the portion of their interest expense that is allocable to the tax-exempt bonds that they own. The Act modifies the formula used to calculate the portion of interest allocable to the tax-exempt bonds the financial institutions own, so that tax-exempt obligations issued in 2009 or 2010 are not taken into account. The amount of tax-exempt obligations not taken into account by reason of this new rule may not exceed two percent of the average adjusted bases for all assets of the financial institution. In addition, with respect to "qualified small issuer" bonds, the Act modifies the rule that exempts such bonds from the amount of tax-

exempt obligations in the interest disallowance calculation. The Act increases from $10,000,000 to $30,000,000, the amount of bonds that can be issued by a "qualified small issuer" in determining whether a bond issued in 2009 or 2010 qualifies for the small issuer exemption. In the case of a qualified 501(c)(3) bond issued during 2009 or 2010, the nonprofit organization for whose benefit such bond was issued will be treated as the issuer.

Tax-Exempt Interest Not Subject to AMT Tax-exempt interest on a private activity bond issued in 2009 or 2010 is not subject to the alternative minimum tax. A refunding bond is eligible for this exemption if the bond being refunded was issued in 2004 through 2008.

Qualified School Construction Bonds and Qualified Zone Academy Bonds The Act provides for the issuance of qualified school construction bonds (tax credit bonds) in the amount of $11 billion in each of 2009 and 2010. This amount is allocated among the states, with the proceeds to be used for the construction, rehabilitation, or repair of public school facilities. The national limitation for qualified zone academy bonds (tax credit bonds) is increased to $1.4 billion for each of 2009 and 2010.

Significant Individual and Family Tax Provisions

Making Work Pay Credit The Act provides a tax credit equal to 6.2% of a taxpayer's earned income. The credit is capped at $400 for individuals and $800 for joint filers. The credit is available in 2009 and 2010 and is refundable. The credit begins phasing out for individual taxpayers with an AGI of $75,000 ($150,000 for married filing jointly) and is completely phased out for individual AGIs of $95,000 ($190,000 for married filing jointly). The credit is not considered income to recipient nor considered as a resource for purpose of determining eligibility under any federal program. This credit costs $114 billion or more than 14% of the cost of the stimulus package.

American Opportunity Work Credit The Act creates a tax credit of up to $2,500 per student per year for qualified costs for the first four years of college. The credit rate is equal to 100% of the first $2,000 of qualified expenses and 25% of the next $2,000 of expenses. The credit phases out for individual taxpayers with AGI between $80,000 and $90,000 and joint filers with AGI between $160,000 and $180,000. Forty percent of the credit is refundable.

Alternative Minimum Tax The Act increases the 2009 exemption amount for calculation of the AMT to $46,700 for individuals and $70,950 for joint returns. The provision prevents approximately 24 million taxpayers from becoming subject to the AMT. This provision accounts for $70 billion of the cost of the stimulus package.

Other Individual Provisions The Act suspends taxation of certain unemployment benefits for 2009; increases the earned income tax credit for certain families for 2009 and 2010 and increases the refundable portion of the child care credit for 2009 and 2010; allows computers and computer technology to qualify as expenses under 529 plans for 2009 and 2010; equalizes the tax-free benefit payable by employers for parking and transit benefits for 2009 and 2010; and permits the deduction of sales tax paid on the first $49,500 of the purchase price of a new car, light truck, motorcycle or motor home. The sales tax deduction phases out for individual taxpayers with AGI between $125,000 and $135,000 ($250,000 and $270,000 on a joint return).

If you have questions about the American Recovery and Reinvestment Tax Act of 2009 and the impact it may have on your organization, please contact one of our **tax** attorneys:

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