

## **BREAKING TAX NEWS BULLETIN**

### **President Obama Signs Stimulus Bill That Includes Help for Affordable Housing**

On February 13, 2009, both the House and Senate passed the American Recovery and Reinvestment Act of 2009 (the “Stimulus Act” or the “Act”). President Obama signed the bill into law on February 17, 2009.

The major tax change for the low-income housing tax credit (“LIHTC”) industry is the new grant program.

- LIHTC Credit Exchange. The Act allows States to exchange certain 2008 or 2009 LIHTC for grants that would then be used for buildings that would qualify under Section 42. Grants could be used in conjunction with an allocation of LIHTC or could be used on qualifying projects that go forward without using any LIHTC.

The attached Tax Update Bulletin discusses how the new credit exchange program works and provides commentary regarding the numerous questions created by the new program. The Tax Update Bulletin also discusses other tax changes in the Act that are applicable to the housing and tax credit industry including:

- Ability to Use Tax-Exempt Bonds or Subsidized Energy Financing with Energy Credit Property
- Grants In Place of Investment Credit for Energy Credit Property
- Ability to Elect to Take Investment Tax Credit in place of Renewable Energy Production Credit
- Extension of Renewable Energy Production Credit
- Reinstatement of 50% Bonus Depreciation
- Additional New Markets Tax Credit (“NMTC”) Allocations
- Debt Restructuring Help Through New Rules for Debt Forgiveness and Reacquisitions

Also attached is a Fact Sheet providing some information about some of the non-tax appropriations portion of the Stimulus Act that will impact the housing industry. These include:

- \$2.25 billion of HOME funds to fill gaps in LIHTC projects
- \$2 billion Project-Based Rental Assistance for Section 8, 202/811 projects
- \$250 million for Energy Retrofits for Section 8, 202/811 projects
- \$4 billion Public Housing Capital Fund
- \$1 billion CDBG
- \$2 billion for Neighborhood Stabilization Program
- \$1.5 billion Homeless Prevention



A copy of this Bulletin, the Fact Sheet and the Act are available at <http://www.att-law.com/publication.html>. References to “Code” in refer to the Internal Revenue Code of 1986, as amended.

Additional Information – For questions related to the new legislation, please contact Glenn Graff at 312-491-3313 or [ggraff@att-law.com](mailto:ggraff@att-law.com).

Tax Opinion Disclaimer – Please note that this Bulletin and the Fact Sheet are only summaries of a long and complex statute. Please contact your tax advisor with respect to applying the new rules. The Bulletin and Fact Sheet are not intended to be used, and may not be used by any direct or indirect recipient, for the purpose of (i) avoiding any penalties that may be imposed on such recipient, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

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## **TAX UPDATE BULLETIN**

### **EXPLANATION AND COMMENTARY ON SELECT HOUSING AND TAX CREDIT PROVISIONS OF THE STIMULUS ACT, THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009 (THE “ACT”)**

#### **1. Exchange Low-Income Housing Tax Credits (“LIHTCs”) for Grants (Act Sections 1404 and 1602)**

For 2009 the U.S. Treasury will provide a grant to state housing credit agencies (“Credit Agency”) and the Credit Agencies can then make subawards of the grant funds to projects. The grant amount is equal to the following formula:

$$\text{Grant Amount} = 10 \times 85\% \times \text{LIHTC Amount Elected by State}$$

*Comment* – This is equivalent to a project receiving \$0.85 per LIHTC from a tax credit investor

- a. **Limit on Amount Exchanged** – A Credit Agency can elect to exchange LIHTC up to the following amounts: (i) 100% of unused housing credit ceiling for 2008, (ii) 100% of any previously allocated LIHTCs returned to the State in 2009, (iii) 40% of a States 2009 LIHTC allocation, and (iv) 100% of a State’s share of the National Pool.

*Comment* – Allowing 100% of returned credits to be converted to grants, should help projects which have received 2008 credits but have been unable to find a tax credit investor. With the cooperation of the State, such projects should be able to return their 2008 Credits and instead receive a grant.

*Comment* – Because of the technical nature of the exchange provisions of the Act and how such provisions interact with the supplemental disaster area LIHTC created in the Emergency Economic Stabilization Act of 2008 (“EESA”), it appears that the Act does not allow a State to exchange any of the supplemental 2009 disaster area LIHTC. Furthermore, it is unclear if pre-2009 allocations of disaster area LIHTC under EESA (or even GO Zone LIHTC) can be returned in 2009 under IRS regulations. If such LIHTC could be returned, for example by the return of a carryover allocation of disaster area LIHTC, then such LIHTC would be eligible for 100% exchange under (ii) above. However, in an informal discussion with the IRS their position was that because GO Zone and disaster area LIHTC are lost if not allocated by the end of the relevant year, the result is that such supplemental LIHTC could not be returned in a subsequent year and therefore such supplemental LIHTC are ineligible for exchange. The IRS acknowledged that this area was unclear. Clarification of these areas will likely be a top priority for states with special allocations of disaster area LIHTC or GO Zone LIHTC

- b. **Subawards of Grants** – Grants are awarded to the Credit Agency and the Credit Agency then makes a subaward of the grant funds to finance the construction or acquisition and rehabilitation of Section 42 qualified low-income buildings.

*Comment* – Can grant funds be used for reserves and other project costs which are not construction, acquisition or rehabilitation?

- i. Grants to Projects with LIHTC Allocations – The Act allows grant funds to be awarded to projects that also have an allocation of LIHTC. Such awards would then be used to fill project financing gaps.
- ii. Grants to Projects without LIHTC Allocations – The Act also allows grants to projects that do not have an LIHTC allocation so long as the buildings are Section 42 qualified low-income buildings.
  - Requirements – For projects without allocations, a grant may be made only if the state “makes a determination that such use will *increase the total funds available to the State to build and rehabilitate affordable housing.*” The statute goes on to state that “in complying with such determination requirement, a State housing credit agency shall establish a process in which applicants that are allocated credits are required to demonstrate *good faith efforts to obtain investment commitments* for such credits before the agency makes such subawards.”

*Comment* – The requirement that the grant would “increase the total funds available to the State” raises a number of issues.

- *If a project cannot find an investor but there is another project (say in an urban area) that could use the allocation of credits, does allowing the grant really increase the total funds available to the state? Presumably this interpretation will not be used because such a result would prevent grants from being used in rural areas which are the areas hardest hit with a lack of LIHTC investor interest.*
- *Would a project have to show that it had no investor interested in its tax credit equity or would a mere showing that the investor was paying less than the \$0.85 per credit would be sufficient. A middle approach might be to require a showing that the project was not financially feasible at the credit pricing that is offered.*

*Comment* – The language requiring a “good faith determination” is confusing. It seems to say that before a grant is made to a project without an allocation, the Credit Agency must establish a process in which applicants that are allocated credits have made a good faith effort to find an investor. One explanation would be that grants can be made only to projects that have previously been allocated credits but were unable to find an investor and have instead returned the credits and requested a grant. If this interpretation is used, Credit Agencies may implement a process to make 2009 reservations and allocations and then allow recipients that cannot find an investor to apply to exchange the credits for a grant. This would be even simpler for projects that already have an allocation of 2008 credits. Likely they can easily show many unsuccessful efforts to obtain an investor.

*Comment* – A procedure will need to be put in place for how a project that doesn’t have an allocation can show that it made a good faith effort to find an investor for its possible allocation? Is a certification by the developer of such efforts sufficient, perhaps with a list of investors who have been contacted? Or would Credit Agencies require some sort of reverse commitment letters, i.e., a letter from an investor saying they are not interested? Would investors be willing to expend the effort to write such letters for projects they are not interested in?

- c. Subawards as Grants or Loans – The Act does not address whether “subawards” will be made as grants or loans to project owners. The Act also does not address whether grants

are taxable income to recipients, however the Joint Explanatory Statement issued by the Senate and House reconciliation committee accompanying the Act states such grants are not taxable income to the recipients.

*Comment* – It is troubling that the Act does not specifically state that the grants are not taxable income to the recipients. In contrast, the new grant provisions in Section 1104 the Act for energy credits (see discussion in Section 3 below) specifically provide that such grants are not includible in the gross income of the taxpayer. As a result, a strict view would that when Congress meant to exclude something from taxable income, they knew how to do it in the statute itself and therefore the grant of a subaward is taxable income to the recipient. However, it is significant that there is explicit language in the Joint Explanatory Statement. In addition, it does not make sense to tax such grants as the result would be a shortfall in funds to build the low-income projects. For example, if tax must be paid on receipt of the grant then \$1 of foregone credits, which produces \$0.85 of a grant subaward, would only result in approximately \$0.55 of after-tax proceeds available to build the qualified low-income building. This amount is even less than the current diminished LIHTC pricing. We have had informal discussions with the IRS on this issue and the IRS seemed open to the possibility of issuing guidance that grants are not taxable income to the recipients. Applegate & Thorne-Thomsen will be working with other industry practitioners to submit a request for guidance on this issue.

*Comment* – Some States may choose to provide grants to building owners in the form of “soft loans”, i.e. loans without current debt service with repayment due at maturity. Such loans are already commonplace in the low-income housing field. While soft loans may avoid the issue of whether there is taxable income from receipt of a grant, other issues may be created. For particular projects there may be difficulty showing an ability to repay the loans so that such loans constitute bona fide indebtedness. In addition, recipients of such a loan will one day have to repay the indebtedness or try to work out a refinancing or forgiveness. Repayment is obviously an economic detriment versus tax credit equity which often does not have to be repaid (subject to capital account requirements). Refinancing or forgiveness would bring up tax issues such as original issue discount issues from non-interest bearing loans or cancellation of indebtedness income. It is hoped that the IRS will provide guidance showing that subawards, whether in the form of forgivable loans or grants are not taxable income.

- d. **Basis Reduction** – The Act adds a new Section 42(i)(9)(B) which states that “Basis of a qualified low-income building shall not be reduced by the amount of any grant [received pursuant to the exchange program].” This raises important issues discussed in the comment below

*Comment* – The Act’s amendment to Section 42 does not indicate whether there is no reduction in eligible basis, depreciable basis or both. Based on the fact that the Act amends Section 42 rather than the depreciable basis provisions of the Code, most practitioners have concluded that at a minimum Congress intended that there would not be a reduction in eligible basis. However, an informal discussion with the IRS indicates that they have a contrary interpretation based on their discussions with Treasury and because the Act says only “basis” rather than “eligible basis.” Under this view, the general provision of Section 42(d)(5) dealing with Federal grants would apply and require a reduction in eligible basis for costs funded with such a grant. In discussions with the IRS on this topic, we pointed out that such an interpretation would significantly impair the ability to use the grant of a subaward to fill gaps for projects that are also using an allocation of LIHTC. If the grant of a subaward reduced eligible basis, then the amount of LIHTC that the project could support would be reduced, resulting in less LIHTC equity and an increased gap. The IRS seemed open to the problems created by such an interpretation and requested commentary from practitioners. Applegate & Thorne-Thomsen will be working with other practitioners to submit such commentary.

- e. Grant Projects Must Meet Section 42 Limitations – The Act requires that any subaward to a qualified low-income building shall be made in the same manner and shall be subject to the same limitations (including rent, income, and use restrictions on such building) as a building receiving an LIHTC allocation.

*Comment* – Will the above be interpreted to impose QAP requirements and carryover allocation deadlines on grant projects? For example, must a project be placed in service by the end of the second calendar year after the allocation? Will a project be required to have incurred 10% of project costs within a year of the subaward?

*Comment* – The above provision makes it clear that extended use agreements will be required.

- f. Process for Obtaining Grants – The Act is silent on the process to be used by Credit Agencies to apply for grants.

*Comment* – The Act leaves a number of questions open with respect to actually obtaining grant funds and the Treasury Department will need to issue guidelines on this process. For example, once a Credit Agency applies for a grant, how quickly will the Treasury disburse the funds? Will Credit Agencies be able to request grants on a rolling basis as individual projects are approved for grants? Or conversely will Credit Agencies have to make the entire grant request for 2009 all at once? The latter approach would be difficult, especially for states that have not yet allocated all of their 2009 LIHTC. Also, projects that unexpectedly run into difficulty later in 2009 might have missed the deadline to apply to return their credits and receive a grant.

*Comment* – How Credit Agencies will disburse the subawards is unclear. Will all the money be available upfront, must it be disbursed pro rata with other funds or will some of the common milestones used by equity investors be used? To the extent that a Credit Agency has received grant funds but has not disbursed them, what will happen to interest earned on the grant funds? Would the interest be considered program income of the Credit Agency? Or would the interest be treated as an additional grant funds subject to the same restrictions and benefits?

- g. Subaward Deadline – The Act requires that any grant funds not used to make subawards before January 1, 2011 must be returned to the Treasury.

*Comment* – It is unclear if a subaward must actually be disbursed before January 1, 2011 or if a commitment of the funds from a Credit Agency by such date will be sufficient. Given the overall purpose of the stimulus bill to make sure that funds are used quickly to stimulate the economy, it is possible disbursement could be required.

- h. Asset Management – The Act requires that the Credit Agency perform its own asset management for buildings funded with a subaward of grant funds. Credit Agencies are allowed to contract for such asset management and may cover the expense of asset management.

*Comment* – It is unclear exactly what services will be included in the State asset management function. Syndicator asset management services tend to occur at least annually and examine the health of the project above and beyond just a review of tenant files and rents.

*Comment* – The purpose of this rule seems to be to fill the void normally provided by investors who typically provide asset management services. It is said that one of the keys to the success of the LIHTC program is the multiple levels of supervision—i.e., there is supervision at the developer and syndicator/investor level as well as compliance audits at the state level. The elimination of the syndicator/investor asset management function was likely seen as a weakness in the grant approach and therefore state asset management was required.

*It is noteworthy that the state asset management function appears to be required even where grants are given to a project which also has an allocation of state credits. This will create a duplication of asset management functions by the state and the syndicator/investor. In addition, because states are separately required to audit projects and file IRS Forms 8823 when they observe non-compliance, there may be concerns from project owners as to how the state participation in asset management will interact with state audits and the issuance of Forms 8823. A primary role of syndicator/investor asset management is to proactively identify and correct issues before a state commences an audit. One has to wonder if a state's asset management function will similarly work in such a problem avoidance role as opposed to an audit/enforcement role. For example, if a problem observed during asset management could trigger issuance of a Form 8823 or cause the grant to be recaptured, then the process could become adversarial.*

- i. **Recapture of Subaward** – The Stimulus Act requires that a Credit Agency must impose conditions or restrictions, including a requirement for recapture, to ensure that a building receiving a subaward remains a “qualified low-income building” during the 15-year compliance period. Such recapture will be enforceable by a mortgage lien or similar measures approved by the Treasury. Recaptured funds must be returned to the Treasury.

*Comment – This recapture requirement is different from tax credit recapture which is only for 1/3 of credits and decreases over time. How this language is interpreted will be extremely important to project owners. For example, the statutory language could conceivably result in 100% recapture in the 14th year whereas LIHTC recapture would be much lower. LIHTC recapture also includes an interest component, but the subaward recapture language does not address this facet. It is hoped that Treasury will issue guidance providing that subaward recapture will work in a manner similar to tax credit recapture.*

*Comment – LIHTC recapture occurs merely from a reduction in a building's applicable fraction, i.e., percentage of low-income units/floorspace. The subaward recapture language literally requires recapture only if a building fails to be a “qualified low-income building.” Section 42 defines a qualified low-income building as a building which is part of a project that meets the “minimum set-aside” of (i) either 20% of units being rented to persons at 50% of area median income, or (ii) 40% of units being rented to persons at 60% of area median income. Thus if recapture was limited to situations where a building violates the minimum set-aside, then a project receiving a subaward could end up with significantly fewer low-income units than expected but still not trigger recapture. It is notable that States will continue to require the recordation of extended use agreements that will require that the promised number of low-income units be delivered. However, extended use agreements are enforced via contractual remedies rather than the threat of recapture would. It may be that the States or Treasury will allow for recapture where the promised number of low-income units is not maintained, even if there continue to be enough low-income units to avoid violating the minimum set-aside. This would be the result if recapture is interpreted to be similar to recapture on projects that have an allocation of LIHTC.*

## **2. Repeal of Certain Limitations on Credit for Renewable Energy Property (Act Section 1103)**

Section 48 of the Code provides a 10% or 30% credit for the cost of certain alternative energy property. The Act removes the prior requirement that the basis for the energy credit property must be reduced by the portion of the property financed with tax-exempt bonds or subsidized energy financing.

*Comment – Section 48(a)(4)(C) defined subsidized energy financing as “financing provided under a Federal, State, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.” The result of such reduction was a decrease in the effectiveness of state funding programs or tax-exempt bonds programs designed to encourage renewable*

*energy projects because the subsidy indirectly resulted in less federal credits. The elimination of such provisions will provide more federal credits (or grants as described below) where such property also received subsidized energy financing or uses tax-exempt bonds. This increase in credits should increase the feasibility of such projects allowing more renewable energy projects to go forward. This achieves one of the stated purposes of the stimulus legislation which was to increase the amount of the United States' electricity produced from renewable resources.*

### **3. Grants for Specified Energy Property In Lieu of Tax Credits (Act Sections 1104 & 1603)**

The Stimulus Act allows owners of certain energy property to apply to receive a grant of money in lieu of the energy credits under Section 48. Grants are available either equal to 30% or 10% of the basis of qualifying property. Thirty percent grants are available for qualified fuel cell property, solar property, qualified small wind property, all as defined under Section 48. Thirty percent grants are also available for certain property qualifying for the production tax credit under Section 45 (see below). Ten percent grants are available for geothermal, qualified microturbine, combined heat and power property and geothermal heat pumps.

*Comment – The current economic climate has significantly reduced or eliminated the tax credit appetite of many of the traditional investors in energy investment credits or energy production credits. As a result, many projects that are otherwise feasible have not been able to find an investor for their tax credits or have found that the pricing for such credits has decreased. This has resulted in a decrease in the number of energy credit projects under construction. The provision for grant funds in lieu of tax credits for qualifying properties should be a significant help to projects that are financially feasible but have not been able to begin construction due to the impaired market for energy credits. An additional result may be that the availability of grants in place of credits may result in a significant reduction in the amount of energy credits available to be purchased by syndicators and direct investors in such credits.*

*Comment – Energy grants are not available for certain non-taxpayers and may create issues that were easier to address when receiving credits rather than grants. In general, energy grants under the Act are not available for (i) Federal, State or local governments (or any political subdivision, agency, or instrumentality thereof), (ii) 501(c) organizations, and (iii) Section 54(j)(4) issuers, i.e. clean renewable energy bond lenders, cooperative electric companies and governmental bodies. Importantly, the new law also specifically disallows the grants for any partnership or pass-thru entity any partner (or other holder of an equity or profits interest) of which is described in the foregoing clauses (i)-(iii). This means that a partnership or other pass-thru entity with a governmental entity or 501(c) organization as a small partner may not qualify for any grants. This appears to be more restrictive than the restrictions on obtaining tax credits where tax-exempt entities participate in partnerships or pass-thru entities. When using credits the tax-exempt use rules under Section 168(h)(6) reduce the amount of credits where a tax-exempt entity does not have a “qualified allocation.” A qualified allocation exists where for all years that the tax-exempt entity is a member it has an allocation consistent with it receiving the same share of all items of partnership income, gain, loss, deduction, credit and basis. The tax-exempt use rules could also be avoided in the credit context by having the tax-exempt entity participate in the partnership through a taxable corporation that makes an election under Section 168(h)(6)(F)(ii). Thus, it was possible for tax-exempt entities to participate in energy credit projects if the tax-exempt entity limited itself to a qualified allocation or used a Section 168(h)(6)(F)(ii) structure. However the new grant law does not contain a provision allowing the grants where the tax-exempt entity has a qualified allocation. It is possible that the IRS could issue guidance whereby the grants would only be disallowed to the extent a non-taxpayer does not have a qualified allocation. However, the likelihood of such guidance is unclear at this time.*

- a. Timing of Grant Payments – Grants will be paid within 60 days of the later of an application for the grant or the date the property is placed in service.
- b. Treatment of Grant Payments – The Act provides that the grant payments are not includible in gross income of the grant recipient. The Act also provides that in calculating the amount of the grant payment the grant payment can be included in the property's basis. However, similar to properties that take the Section 48 energy credits rather than a grant, the depreciable basis of the property is reduced by half of the amount of the grant.
- c. Expiration – Congress has provided a fairly generous placement in service deadline in order to receive the energy grants. To be eligible for the grants, the property must be placed in service in 2009 or 2010 or the property can be placed in service after 2010 if construction of the property began in 2009 or 2010 and is completed prior to the Credit Termination Date. The Credit Termination Date is (i) January 1, 2013 for qualified wind facilities under Section 45(d)(1), (ii) January 1, 2014 for other section 45 properties which are allowed to elect the investment credit under Section 48, and (iii) January 1, 2017 for traditional energy credit properties under Section 48.

#### **4. Election of Investment Credit In Lieu of Production Credit (Act Section 1102)**

The Stimulus Act allows projects which would have qualified for the tax credit under Section 45 for the production of renewable electricity to claim the 30% investment tax credit under Section 45.

*Comment* – Property for which an election is made to qualify for the Section 48 investment tax credit is also eligible for the 30% grants described above.

*Comment* – The receipt of an energy credit or grant rather than the production credit is a significant change for qualifying property. Rather than receiving a production credit over 10 years, such property would be eligible to receive a 30% credit or grant in the year such property is placed in service. The ability to receive the credit or grant at such an early date should help owners finance such projects.

*Comment* – The ability to receive credits on capitalized costs including a development fee may create a significant incentive for property owners to make this election.

#### **5. Extension of Production Credit (Act Section 1101)**

The Section 45 Credit for the production of electricity from renewable sources has been extended for certain properties which are placed in service prior to the dates below:

- January 1, 2013 - wind property
- January 1, 2014 - closed loop biomass, open loop biomass, geothermal, landfill gas, trash combustion, hydropower, and marine and hydrokinetic properties.

#### **6. Reenactment of 50% Bonus Depreciation (Act Section 1201)**

The Act reenacts 50% bonus depreciation which had previously expired on December 31, 2008. As with the prior bonus depreciation, qualifying property must have a depreciation recovery period of less than 20 years.

*Comment – For real estate projects bonus depreciation would not be available for building costs but would be available for personal property and site improvements. In addition, for site improvements that qualify for the longer production period provision described below, placement in service can occur during 2010 although bonus depreciation will be limited to costs incurred prior to January 1, 2010.*

- a. Retroactive Application – The Act generously allows bonus depreciation for property placed in service before enactment of the Act but after December 31, 2008.
- b. Placement In Service Deadline– Bonus depreciation is available for qualifying property placed in service before January 1, 2010 and for certain longer production period property placed in service before January 1, 2011.
  - Limited Bonus Depreciation in 2010 – As with the prior bonus depreciation, property qualifying for placement in service after January 1, 2010 but before January 1, 2011 will only receive bonus depreciation on costs incurred prior to January 1, 2010.

## **7. Increase In New Markets Tax Credit (Act Section 1403)**

The Act increases the New Markets Tax Credits under Section 45D for each of 2008 and 2009 from \$3,500,000 to \$5,000,000.

*Comment – This substantial increase in credits should provide additional financing for qualifying businesses in low-income communities. However, the credit is still scheduled to expire after 2009. It is hoped that the credit will be continued by legislation passed later in 2009.*

## **8. New Rules Relating To Reacquisitions Of Debt Instruments (Act Section 1231)**

Generally, if a taxpayer acquires its own debt at a discount, Code Section 108 will treat the taxpayer as having taxable cancellation of debt (“COD”) income. The Act amends Code Section 108 by adding a new subsection 108(i) entitled “Deferral and Ratable Inclusion of Income Arising from Business Indebtedness Discharged by the Reacquisition of a Debt Instrument.”

- a. Elective Application of Rules and Timing Requirement – Relief under these new rules is elective and applies to “reacquisitions” of “applicable debt instruments” occurring after December 31, 2008 and before January 1, 2011.
- b. Applicable Debt Instruments – For purposes of these new rules, an “applicable debt instrument” is any instrument issued by a C corporation or issued by any other person (i.e., any other individual, trust, estate, partnership, association, company or corporation) in connection with such person’s conduct of a trade or business.
- c. Reacquisition – The term “reacquisition” includes (i) the acquisition of the debt instrument for cash, (ii) the exchange of one debt instrument for another (including an exchange resulting from a modification of the debt instrument), (iii) the exchange of the debt instrument for corporate stock or a partnership interest, and (iv) the contribution of the debt instrument to capital. Importantly the term also includes the complete forgiveness of the indebtedness by the holder of the debt instrument.
- d. Treatment of Reacquired Debt – If a reacquisition occurs and an election is made, any COD income resulting from such a reacquisition will be includible ratably in gross

income over a 5-year period beginning either with (i) the fifth taxable year following the taxable year in which the reacquisition occurs if the reacquisition occurs in 2009, or (ii) the fourth taxable year following the taxable year in which the reacquisition occurs if the reacquisition occurs in 2010.

*Comment – If a taxpayer had \$1,000,000 of debt forgiven in 2009 or 2010, it would include \$200,000 in taxable income each year from 2014 through 2018.*

- e. Reacquisition through Swap of Debt Instruments – If the reacquisition occurs as a result of a swap of debt instruments, there are rules deferring any interest deductions resulting from Original Issue Discount (“OID”) on the new instrument so that such deductions would not be taken until the corresponding COD income is recognized during one of the foregoing 5-year periods.