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REPORT
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MAKING SUPPLEMENTAL APPROPRIATIONS FOR JOB PRESERVA-
TION AND CREATION, INFRASTRUCTURE INVESTMENT, ENERGY
EFFICIENCY AND SCIENCE, ASSISTANCE TO THE UNEMPLOYED,
AND STATE AND LOCAL FISCAL STABILIZATION, FOR THE FIS-
CAL YEAR ENDING SEPTEMBER 30, 2009, AND FOR OTHER PUR-
POSES

CONFERENCE REPORT

TO ACCOMPANY

H.R. 1



FEBRUARY 12, 2009.—Ordered to be printed

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement amends section 382 of the Code to provide an exception from the application of the section 382 limitation. Under the provision, the section 382 limitation that would otherwise arise as a result of an ownership change shall not apply in the case of an ownership change that occurs pursuant to a restructuring plan of a taxpayer which is required under a loan agreement or commitment for a line of credit entered into with the Department of the Treasury under the Emergency Economic Stabilization Act of 2008, and is intended to result in a rationalization of the costs, capitalization, and capacity with respect to the manufacturing workforce of, and suppliers to, the taxpayer and its subsidiaries.⁷⁹

However, an ownership change that would otherwise be excepted from the section 382 limitation under the provision will instead remain subject to the section 382 limitation if, immediately after such ownership change, any person (other than a voluntary employees' beneficiary association within the meaning of section 501(c)(9)) owns stock of the new loss corporation possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote or of the total value of the stock of such corporation. For purposes of this rule, persons who bear a relationship to one another described in section 267(b) or 707(b)(1), or who are members of a group of persons acting in concert, are treated as a single person.

The exception from the application of the section 382 limitation under the provision does not change the fact that an ownership change has occurred for other purposes of section 382.⁸⁰

Effective date.—The conference agreement applies to ownership changes after the date of enactment.

8. Deferral of certain income from the discharge of indebtedness (sec. 1231 of the Senate amendment, sec. 1231 of the conference agreement, and sec. 108 of the Code)

PRESENT LAW

In general, gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, certain real property business indebtedness, and certain qualified principal residence indebtedness.⁸¹ In cases involving discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally are required to reduce certain tax attributes, including net operating losses, general business credits,

⁷⁹This exception shall not apply in the case of any subsequent ownership change unless such subsequent ownership change also meets the requirements of the exception.

⁸⁰For example, an ownership change has occurred for purposes of determining the testing period under section 382(i)(2).

⁸¹See sections 61(a)(12) and 108. But see sec. 102 (a debt cancellation which constitutes a gift or bequest is not treated as income to the donee debtor).

minimum tax credits, capital loss carryovers, and basis in property, by the amount of the discharge of indebtedness.⁸²

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge over the aggregate of the liabilities of the taxpayer immediately after the discharge.⁸³

For all taxpayers, the amount of discharge of indebtedness generally is equal to the excess of the adjusted issue price of the indebtedness being satisfied over the amount paid (or deemed paid) to satisfy such indebtedness.⁸⁴ This rule generally applies to (1) the acquisition by the debtor of its debt instrument in exchange for cash, (2) the issuance of a debt instrument by the debtor in satisfaction of its indebtedness, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange), (3) the transfer by a debtor corporation of stock, or a debtor partnership of a capital or profits interest in such partnership, in satisfaction of its indebtedness (an equity-for-debt exchange), and (4) the acquisition by a debtor corporation of its indebtedness from a shareholder as a contribution to capital.

Debt-for-debt exchanges

If a debtor issues a debt instrument in satisfaction of its indebtedness, the debtor is treated as having satisfied the indebtedness with an amount of money equal to the issue price of the newly issued debt instrument.⁸⁵ The issue price of such newly issued debt instrument generally is determined under sections 1273 and 1274.⁸⁶ Similarly, a “significant modification” of a debt instrument, within the meaning of Treas. Reg. sec. 1.1001-3, results in an exchange of the original debt instrument for a modified instrument. In such cases, where the issue price of the modified debt instrument is less than the adjusted issue price of the original debt instrument, the debtor will have income from the cancellation of indebtedness.

If any new debt instrument is issued (including as a result of a significant modification to a debt instrument), such debt instrument will have original issue discount equal to the excess (if any) of such debt instrument’s stated redemption price at maturity over its issue price.⁸⁷ In general, an issuer of a debt instrument with original issue discount may deduct for any taxable year, with respect to such debt instrument, an amount of original issue discount equal to the aggregate daily portions of the original issue discount for days during such taxable year.⁸⁸

⁸² Sec. 108(b).

⁸³ Sec. 1017.

⁸⁴ Treas. Reg. sec. 1.61-12(c)(2)(ii). Treas. Reg. sec. 1.1275-1(b) defines “adjusted issue price.”

⁸⁵ Sec. 108(e)(10)(A).

⁸⁶ Sec. 108(e)(10)(B).

⁸⁷ Sec. 1273.

⁸⁸ Sec. 163(e).

Equity-for-debt exchanges

If a corporation transfers stock, or a partnership transfers a capital or profits interest in such partnership, to a creditor in satisfaction of its indebtedness, then such corporation or partnership is treated as having satisfied its indebtedness with an amount of money equal to the fair market value of the stock or interest.⁸⁹

Related party acquisitions

Indebtedness directly or indirectly acquired by a person who bears a relationship to the debtor described in section 267(b) or section 707(b) is treated as if it were acquired by the debtor.⁹⁰ Thus, where a debtor's indebtedness is acquired for less than its adjusted issue price by a person related to the debtor (within the meaning of section 267(b) or 707(b)), the debtor recognizes income from the cancellation of indebtedness. Regulations under section 108 provide that the indebtedness acquired by the related party is treated as new indebtedness issued by the debtor to the related holder on the acquisition date (the deemed issuance).⁹¹ The new indebtedness is deemed issued with an issue price equal to the amount used under regulations to compute the amount of cancellation of indebtedness income realized by the debtor (i.e., either the holder's adjusted basis or the fair market value of the indebtedness, as the case may be).⁹² The indebtedness deemed issued pursuant to the regulations has original issue discount to the extent its stated redemption price at maturity exceeds its issue price.

In the case of a deemed issuance under Treas. Reg. sec. 1.108-2(g), the related holder does not recognize any gain or loss, and the related holder's adjusted basis in the indebtedness remains the same as it was immediately before the deemed issuance.⁹³ The deemed issuance is treated as a purchase of the indebtedness by the related holder for purposes of section 1272(a)(7) (pertaining to reduction of original issue discount where a subsequent holder pays acquisition premium) and section 1276 (pertaining to acquisitions of debt at a market discount).⁹⁴

Contribution of a debt instrument to capital of a corporation

Where a debtor corporation acquires its indebtedness from a shareholder as a contribution to capital, section 118⁹⁵ does not apply, but the corporation is treated as satisfying such indebtedness with an amount of money equal to the shareholder's adjusted basis in the indebtedness.

HOUSE BILL

No provision.

⁸⁹ Sec. 108(e)(8).

⁹⁰ Sec. 108(e)(4).

⁹¹ Treas. Reg. sec. 1.108-2(g).

⁹² Id.

⁹³ Treas. Reg. sec. 1.108-2(g)(2).

⁹⁴ Id.

⁹⁵ Section 118 provides, in general, that in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

SENATE AMENDMENT

The provision permits a taxpayer to elect to defer income from cancellation of indebtedness recognized by the taxpayer as a result of a repurchase by (1) the taxpayer or (2) a person who bears a relationship to the taxpayer described in section 267(b) or section 707(b), of a “debt instrument” that was issued by the taxpayer. The provision applies only to repurchases of debt that (1) occur after December 31, 2008, and prior to January 1, 2011, and (2) are repurchases for cash. Thus, for example, the provision does not apply to a debt-for-debt exchange or to any exchange of the taxpayer’s equity for a debt instrument of the taxpayer. For purposes of the provision, a “debt instrument” is broadly defined to include any bond, debenture, note, certificate or any other instrument or contractual arrangement constituting indebtedness.

Income from the discharge of indebtedness in connection with the repurchase of a debt instrument in 2009 or 2010 must be included in the gross income of the taxpayer ratably in the eight taxable years beginning with (1) for repurchases in 2009, the second taxable year following the taxable year in which the repurchase occurs or (2) for repurchases in 2010, the taxable year following the taxable year in which the repurchase occurs. The provision authorizes the Secretary of the Treasury to prescribe such regulations as may be necessary or appropriate for purposes of applying the provision.

Effective date.—The provision applies to discharges in taxable years ending after December 31, 2008.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with modifications. The provision permits a taxpayer to elect to defer cancellation of indebtedness income arising from a “reacquisition” of “an applicable debt instrument” after December 31, 2008, and before January 1, 2011. Income deferred pursuant to the election must be included in the gross income of the taxpayer ratably in the five taxable years beginning with (1) for repurchases in 2009, the fifth taxable year following the taxable year in which the repurchase occurs or (2) for repurchases in 2010, the fourth taxable year following the taxable year in which the repurchase occurs.

An “applicable debt instrument” is any debt instrument issued by (1) a C corporation or (2) any other person in connection with the conduct of a trade or business by such person. For purposes of the provision, a “debt instrument” is broadly defined to include any bond, debenture, note, certificate or any other instrument or contractual arrangement constituting indebtedness (within the meaning of section 1275(a)(1)).

A “reacquisition” is any “acquisition” of an applicable debt instrument by (1) the debtor that issued (or is otherwise the obligor under) such debt instrument or (2) any person related to the debtor within the meaning of section 108(e)(4). For purposes of the provision, an “acquisition” includes, without limitation, (1) an acquisition of a debt instrument for cash, (2) the exchange of a debt instrument for another debt instrument (including an exchange resulting from a modification of a debt instrument), (3) the exchange

of corporate stock or a partnership interest for a debt instrument, (4) the contribution of a debt instrument to the capital of the issuer, and (5) the complete forgiveness of a debt instrument by a holder of such instrument.

Special rules for debt-for-debt exchanges

If a taxpayer makes the election provided by the provision for a debt-for-debt exchange in which the newly issued debt instrument issued (or deemed issued, including by operation of the rules in Treas. Reg. sec. 1.108-2(g)) in satisfaction of an outstanding debt instrument of the debtor has original issue discount, then any otherwise allowable deduction for original issue discount with respect to such newly issued debt instrument that (1) accrues before the first year of the five-taxable-year period in which the related, deferred discharge of indebtedness income is included in the gross income of the taxpayer and (2) does not exceed such related, deferred discharge of indebtedness income, is deferred and allowed as a deduction ratably over the same five-taxable-year period in which the deferred discharge of indebtedness income is included in gross income.

This rule can apply also in certain cases when a debtor reacquires its debt for cash. If the taxpayer issues a debt instrument and the proceeds of such issuance are used directly or indirectly to reacquire a debt instrument of the taxpayer, the provision treats the newly issued debt instrument as if it were issued in satisfaction of the retired debt instrument. If the newly issued debt instrument has original issue discount, the rule described above applies. Thus, all or a portion of the interest deductions with respect to original issue discount on the newly issued debt instrument are deferred into the five-taxable-year period in which the discharge of indebtedness income is recognized. Where only a portion of the proceeds of a new issuance are used by a taxpayer to satisfy outstanding debt, then the deferral rule applies to the portion of the original issue discount on the newly issued debt instrument that is equal to the portion of the proceeds of such newly issued instrument used to retire outstanding debt of the taxpayer.

Acceleration of deferred items

Cancellation of indebtedness income and any related deduction for original issue discount that is deferred by an electing taxpayer (and has not previously been taken into account) generally is accelerated and taken into income in the taxable year in which the taxpayer: (1) dies, (2) liquidates or sells substantially all of its assets (including in a title 11 or similar case), (3) ceases to do business, or (4) or is in similar circumstances. In a case under title 11 or a similar case, any deferred items are taken into income as of the day before the petition is filed. Deferred items are accelerated in a case under title 11 where the taxpayer liquidates, sells substantially all of its assets, or ceases to do business, but not where a taxpayer reorganizes and emerges from the title 11 case. In the case of a pass thru entity, this acceleration rule also applies to the sale, exchange, or redemption of an interest in the entity by a holder of such interest.

Special rule for partnerships

In the case of a partnership, any income deferred under the provision is allocated to the partners in the partnership immediately before the discharge of indebtedness in the manner such amounts would have been included in the distributive shares of such partners under section 704 if such income were recognized at the time of the discharge. Any decrease in a partner's share of liabilities as a result of such discharge is not taken into account for purposes of section 752 at the time of the discharge to the extent the deemed distribution under section 752 would cause the partner to recognize gain under section 731. Thus, the deemed distribution under section 752 is deferred with respect to a partner to the extent it exceeds such partner's basis. Amounts so deferred are taken into account at the same time, and to the extent remaining in the same amount, as income deferred under the provision is recognized by the partner.

Coordination with section 108(a) and procedures for election

Where a taxpayer makes the election provided by the provision, the exclusions provided by section 108(a)(1)(A), (B), (C), and (D) shall not apply to the income from the discharge of indebtedness for the year in which the taxpayer makes the election or any subsequent year. Thus, for example, an insolvent taxpayer may elect under the provision to defer income from the discharge of indebtedness rather than excluding such income and reducing tax attributes by a corresponding amount. The election is to be made on an instrument by instrument basis; once made, the election is irrevocable. A taxpayer makes an election with respect to a debt instrument by including with its return for the taxable year in which the reacquisition of the debt instrument occurs a statement that (1) clearly identifies the debt instrument and (2) includes the amount of deferred income to which the provision applies and such other information as may be prescribed by the Secretary. The Secretary is authorized to require reporting of the election (and other information with respect to the reacquisition) for years subsequent to the year of the reacquisition.

Regulatory authority

The provision authorizes the Secretary of the Treasury to prescribe such regulations as may be necessary or appropriate for purposes of applying the provision, including rules extending the acceleration provisions to other circumstances where appropriate, rules requiring reporting of the election and such other information as the Secretary may require on returns of tax for subsequent taxable years, rules for the application of the provision to partnerships, S corporations, and other pass thru entities, including for the allocation of deferred deductions.

Effective date.—The provision is effective for discharges in taxable years ending after December 31, 2008.

9. Modifications of rules for original issue discount on certain high yield obligations (sec. 1232 of the conference agreement and sec. 163 of the Code)

PRESENT LAW

In general, the issuer of a debt instrument with original issue discount may deduct the portion of such original issue discount equal to the aggregate daily portions of the original issue discount for days during the taxable year.⁹⁶ However, in the case of an applicable high-yield discount obligation (an “AHYDO”) issued by a corporate issuer: (1) no deduction is allowed for the “disqualified portion” of the original issue discount on such obligation, and (2) the remainder of the original issue discount on any such obligation is not allowable as a deduction until paid by the issuer.⁹⁷

An AHYDO is any debt instrument if (1) the maturity date on such instrument is more than five years from the date of issue; (2) the yield to maturity on such instrument exceeds the sum of (a) the applicable Federal rate in effect under section 1274(d) for the calendar month in which the obligation is issued and (b) five percentage points, and (3) such instrument has “significant original issue discount.”⁹⁸ An instrument is treated as having “significant original issue discount” if the aggregate amount of interest that would be includible in the gross income of the holder with respect to such instrument for periods before the close of any accrual period (as defined in section 1272(a)(5)) ending after the date five years after the date of issue, exceeds the sum of (1) the aggregate amount of interest to be paid under the instrument before the close of such accrual period, and (2) the product of the issue price of such instrument (as defined in sections 1273(b) and 1274(a)) and its yield to maturity.⁹⁹

The disqualified portion of the original issue discount on an AHYDO is the lesser of (1) the amount of original issue discount with respect to such obligation or (2) the portion of the “total return” on such obligation which bears the same ratio to such total return as the “disqualified yield” (i.e., the excess of the yield to maturity on the obligation over the applicable Federal rate plus six percentage points) on such obligation bears to the yield to maturity on such obligation.¹⁰⁰ The term “total return” means the amount which would have been the original issue discount of the obligation if interest described in section 1273(a)(2) were included in the 101 stated redemption to maturity.¹⁰¹ A corporate holder treats the disqualified portion of original issue discount as a stock distribution for purposes of the dividend received deduction.¹⁰²

HOUSE BILL

No provision.

⁹⁶ Sec. 163(e)(1). For purposes of section 163(e)(1), the daily portion of the original issue discount for any day is determined under section 1272(a) (without regard to paragraph (7) thereof and without regard to section 1273(a)(3)).

⁹⁷ Sec. 163(e)(5).

⁹⁸ Sec. 163(i)(1).

⁹⁹ Sec. 163(i)(2).

¹⁰⁰ Sec. 163(e)(5)(C).

¹⁰¹ Sec. 163(e)(5)(C)(ii).

¹⁰² Sec. 163(e)(5)(B).

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement adds a provision that suspends the rules in section 163(e)(5) for certain obligations issued in a debt-for-debt exchange, including an exchange resulting from a significant modification of a debt instrument, after August 31, 2008, and before January 1, 2010.

In general, the suspension does not apply to any newly issued debt instrument (including any debt instrument issued as a result of a significant modification of a debt instrument) that is issued for an AHYDO. However, any newly issued debt instrument (including any debt instrument issued as a result of a significant modification of a debt instrument) for which the AHYDO rules are suspended under the provision is not treated as an AHYDO for purposes of a subsequent application of the suspension rule. Thus, for example, if a new debt instrument that would be an AHYDO under present law is issued in exchange for a debt instrument that is not an AHYDO, and the provision suspends application of section 163(e)(5), another new debt instrument, issued during the suspension period in exchange for the instrument with respect to which the rule in section 163(e)(5) was suspended, would be eligible for the relief provided by the provision despite the fact that it is issued for an instrument that is an AHYDO under present law.

In addition, the suspension does not apply to any newly issued debt instrument (including any debt instrument issued as a result of a significant modification of a debt instrument) that is (1) described in section 871(h)(4) (without regard to subparagraph (D) thereof) (i.e., certain contingent debt) or (2) issued to a person related to the issuer (within the meaning of section 108(e)(4)).

The provision provides authority to the Secretary to apply the suspension rule to periods after December 31, 2009, where the Secretary determines that such application is appropriate in light of distressed conditions in the debt capital markets. In addition, the provision grants authority to the Secretary to use a rate that is higher than the applicable Federal rate for purposes of applying section 163(e)(5) for obligations issued after December 31, 2009, in taxable years ending after such date if the Secretary determines that such higher rate is appropriate in light of distressed conditions in the debt capital markets.

Effective date.—The temporary suspension of section 163(e)(5) applies to obligations issued after August 31, 2008, in taxable years ending after such date. The additional authority granted to the Secretary to use a rate higher than the applicable Federal rate for purposes of applying section 163(e)(5) applies to obligations issued after December 31, 2009, in taxable years ending after such date.