New Economic Stimulus Legislation Provides Important Tax Relief from COD Income

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The newly enacted economic stimulus legislation (which was signed into law yesterday by President Obama) provides important temporary tax relief to borrowers that would otherwise have recognized taxable cancellation of debt income ("COD Income") in connection with (1) the amendment of a bank loan, bond or other debt instrument (a "debt instrument"), (2) an exchange offer or (3) the repurchase of a debt instrument at a discount by the borrower or certain persons related to the borrower (such as a majority shareholder). The upfront tax cost of COD Income often prevented such transactions from proceeding (or required the terms of such transactions to be modified so as to avoid COD Income). In many cases, the new legislation eliminates this potential roadblock (or significantly reduces its impact) by allowing a borrower to defer completely the recognition of COD Income for four or five years, and, thereafter, to recognize such income ratably over the following five years. In situations where there has been no reduction in the stated principal amount of the borrower's outstanding debt (such as the typical amendment, or a par-for-par debt-for-debt exchange), the new legislation will, in most cases, eliminate entirely the adverse effect of COD Income.

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