

## **DOLLARS AVAILABLE FOR PRIVATE SECTOR IN FEDERAL STIMULUS BUT BE MINDFUL OF IMPORTANT DETAILS**

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (the "Act"). The purposes of the Act include: preserving and creating jobs and promoting economic recovery; providing assistance to those most in need due to the economic recession; making investments that will spur advances in science and health; making investments in environmental protection and infrastructure that will yield long-term benefits; and stabilizing budgets of state and local governments. To accomplish these purposes, the Act authorizes the federal government to spend money and reduce tax burdens. The size and ambition of the Act is unprecedented, as has already been well chronicled in various media outlets.

In this Client Alert, we highlight some specific outlay programs, health law changes, and changes to tax policy that we feel might be of greatest interest to our clients and friends. The Act is gargantuan in its scope, and as a result we expect that many of our clients and friends will encounter some aspects of the Act, directly or indirectly over the coming months and years. Consistent with its stated purposes, much of the Act is designed to spur economic activity and thus will offer business opportunities. At the same time, Congress was concerned about the quality of economic activity generated by the new law. So the Act includes a new set of requirements designed to ensure transparency and accountability. The Act also imposes a variety of labor and materials standards and protections on projects benefiting from the Act's appropriations.

Our Client Alert is organized into the four sections listed below. Click on the title of each section to view the entire section.

### **Section 1. Energy and Resource Conservation and Climate Change**

In this section we summarize select provisions of the Act that support, encourage or even mandate the development, commercialization and adoption of various types of renewable energy resources; energy efficiency improvements and retrofits; and technologies to control or capture, or mitigate the adverse effects of, greenhouse gas emissions from man-made sources. The Act uses a combination of tax incentives and federal expenditures to achieve these goals. We discuss various appropriations that are to be used to support the objectives referred to above. Provisions encouraging tax-exempt bond financing and those related to investment tax credits and production tax credits are discussed in the section entitled "Changes to the Federal Internal Revenue Code."

### **Section 2. Changes to the Federal Internal Revenue Code**

This section provides a summary of significant tax provisions of the Act for businesses, large and small, including (i) a description of the energy provisions, such as the renewal energy production tax credit, expansion of the investment tax credit for other renewable energy facilities, and grants in lieu of these credits; (ii) provisions to encourage new business investment in assets and workers, (iii) tax provisions dealing with tax-exempt bonds and other measures to help state and local governments; and (iv) some tax changes to COBRA. Some of these provisions are quite complex and will require further guidance from the Treasury Department and Internal Revenue Service so the summary contained in this section should not be viewed or relied upon as a full discussion of the law or as legal advice. In addition, the

actual application to any particular taxpayer will depend on that taxpayer's facts and each taxpayer should, therefore, seek advice from the taxpayer's own tax advisors with respect to how the tax provisions of the Act will actually impact his or her businesses. Finally, it must be noted that this section does not discuss the tax provisions in the Act that are primarily directed to individual taxpayers, such as the making work pay credit (to be accomplished through reduced wage withholding) and the increase in alternative minimum tax (AMT) exemption amounts, many of which have already received significant media attention.

### **Section 3. Information Technology in the Healthcare Sector and other Miscellaneous Programs**

The new portion of the Act entitled "Health Information Technology for Economic and Clinical Health Act" (or HITECH Act) is a full-fledged health care law that attempts to create a single national standard for complicated health data. A few decades ago HIPAA revolutionized health care law in the United States. It pushed what had historically been within the sphere of health care providers, their patients and varying state laws into the realm of national solutions. The HITECH Act, summarized in this section, is another giant leap in the same direction.

### **Section 4. Transparency and Labor and Materials Requirements**

New bureaucracies are created by the Act and this section discusses these new bureaucracies that are designed to prevent waste, fraud and abuse in the Act's programs and initiatives. The Act invigorates the roles of the offices of the inspectors general within each agency receiving stimulus funds and expands the scope of their investigatory authority. The Act establishes new oversight and accountability entities that will work, sometimes in tandem with, and sometimes as an adjunct to, the inspectors general. Last, certain provisions of the Act imply that the obligations to account for the use of stimulus money and to be accountable for any failure to use the money in compliance with any conditions or restrictions imposed by the Act, will also apply to contractors, subcontractors and others in the private sector directly or indirectly receiving the funds. This section also summarizes some important rules imposing on all projects that receive funds appropriated under the Act certain prevailing wage and construction materials standards, such as "Buy American" provisions.

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### **SECTION I. ENERGY AND RESOURCE CONSERVATION AND CLIMATE CHANGE**

The Act includes a variety of initiatives aimed at reducing the Nation's dependence on fossil fuels, at preserving natural resources and at addressing the threat of climate change. The emphasis on these types of issues reflects the clearly stated objectives of the Obama Administration and the Democratic leadership in Congress. The money for these programs will take many forms, including grants to states, direct federal expenditures and support for private sector investment via tax and other incentives. Many federal agencies, directly or indirectly, will have some control over these funds. In most cases the Act provides funding to programs or initiatives that are already established, although in some cases the pre-existing programs are not particularly active, whether for prior lack of funding or otherwise. For programs that are already fully functioning, the applicable rules and regulations and program requirements should already be in place and will not require major revisions. For programs that are new or that were moribund, the applicable agency will likely need to go through applicable rule making before funds can be made available. In either situation, the agencies will be challenged by the sheer size of the Act as well as the mandate from Congress that funds appropriated under the Act are to be used quickly. Our summary of the more prominent initiatives in this area follows.

**Energy Efficiency and Conservation Block Grants** - The Department of Energy (DOE) will receive \$3.2 billion for this program. Funds will be available in the form of grants to states, Indian tribes, cities that either have at least 35,000 residents or are otherwise in the top ten most populous cities in their state and counties that either have at least 200,000 residents or are otherwise in the top ten most populous counties in their state. The grants are to be used for programs that will: reduce fossil fuel emissions; decrease energy consumption; or improve efficiency in transportation, building and other areas of the economy. Because this program had not previously received funding, we expect that DOE will have to go through a rule making procedure to establish the parameters of this program, including how grants will be awarded, specifics on eligibility and other relevant program requirements.

**Weatherization Assistance Program** - The DOE, through its Office of Energy Efficiency and Renewable Energy, will receive \$5 billion for weatherization assistance. Under this program, DOE provides technical assistance as well as funding to the states which the states must use to provide weatherization assistance to low income households. The assistance includes payment for the costs of adding insulation, caulking windows and doors and sealing cracks and other areas where energy can be lost to the outdoor elements. According to DOE, the states typically contract with not-for-profit organizations who in turn hire the workers that actually perform the weatherization. The total FY 2008 appropriation for this program was \$0.227 billion. Thus the two year appropriation of \$5 billion represents a 20 fold increase in funding for this program as compared to its last appropriation that was for the fiscal year ended September 30, 2008. The Act also relaxes certain restrictions on eligibility thus expanding both the numbers of households that can benefit from this assistance and the scope of each project that can be supported.

**State Energy Program** - Under this program, grants are provided by DOE to the states to assist them in "adopting emerging renewable energy and energy efficiency technologies." Under the Act, this program will receive \$3.1 billion. From this appropriation DOE will set aside \$2.7 billion for formula grants to the

states with the balance of \$0.4 billion to be reserved for special projects. The formula grants are to be made available to the states as follows: one-third will be distributed equally; one-third will be distributed pro rata based on relative population; and one-third will be distributed based on relative energy consumption. Previously, in order to be eligible to receive funding under this program, in addition to having an eligible project, a state had to contribute at least 20% of the amount of the DOE grant. The state 20% matching requirement is removed under the Act. But, for a state to be eligible for a grant, the governor of the state must certify that the state is undertaking certain measures to: (i) reform utility regulations to encourage end user energy efficiency, (ii) revise building codes to be consistent with current best practices energy standards and (iii) give priority for use of the funds to expansion of existing efficiency programs and programs that support development and deployment of renewable energy. Some examples of how State Energy Program grants have been used previously in Illinois include: The Illinois Sustainable Education Project and The Energy Efficient Affordable Housing Construction Program.

**Innovative Technology Loan Guarantee** - This initiative was first authorized under the Energy Policy Act of 2005 but significant funding and regulatory hurdles have impaired the department's use of this tool. The purpose of the program is for DOE to provide guarantees for loans made in respect of projects that "avoid, reduce, or sequester air pollutants or anthropogenic emissions of greenhouse gases" using new or innovative technologies. Specific types of projects that could be eligible include: renewable energy systems; advance fossil energy technology; hydrogen fuel cell technology; advance nuclear energy facilities; carbon capture and sequestration practices and technologies, including agricultural and forestry practices that store and sequester carbon; efficient electrical generation transmission; efficient end-use energy technologies; production facilities for fuel efficient vehicles, including hybrid and advanced diesel vehicles; pollution control equipment; and refineries. The guidelines issued by DOE indicate the department's intention to limit its guarantee to not more than 80% of the face amount of any loan made to support an eligible project and that the department will consider the amount and source of the borrower's financial commitments to the project. Applicable law requires the department to collect its "Subsidy Cost" from the borrower unless an appropriation is made by Congress. The Subsidy Cost is the calculated long-term liability to the Federal government attributable to its issuance of the subject loan guarantee. Prior to the Act, Congress never appropriated funds for the Subsidy Cost, therefore, it was anticipated that any interested borrower would have to pay that cost from its own funds. The Act appropriates \$6 billion which the department may use to pay Subsidy Costs. Thus the authors of the Act have estimated that this appropriation will support loans in excess of \$60 billion. This appropriation comes with several important restrictions. First, eligible projects are limited to renewable energy systems, electric power transmission systems and leading edge bio-fuel projects meeting certain additional criteria. Second, construction on a project must commence on or before September 30, 2011. Third, the authorization allowing DOE to issue guarantees expires on September 30, 2011. Last, any project receiving guaranteed financing must comply with the prevailing wage requirements of the Davis-Bacon Act.

**Other Energy Appropriations** - Other renewable or other clean energy related programs that received funding under the Act include \$2.5 billion for research and development and demonstration projects including specific allocations for biomass and geothermal projects; \$2.0 billion for grants to support the manufacture of advance vehicle batteries; \$0.3 billion for the Alternative Fuel Vehicles Pilot Grant Program; \$0.4 billion for Transportation Electrification; and \$0.3 billion for the Energy Efficient Appliance Rebate Program.

**Clean Water/Drinking Water Revolving Funds** - USEPA will receive a total of \$6 billion in funding for these revolving funds which are to be used to support programs sponsored by states and the District of Columbia to enhance the delivery of clean water and drinking water. Among the restrictions placed on the use of these revolving funds, USEPA must reserve at least 20%, or \$1.2 billion, for projects that address green infrastructure, water and/or energy efficiency, innovative water quality improvements, decentralized wastewater treatment, storm water runoff mitigation and water conservation. These programs give USEPA authority to make low interest loans to fund environmental infrastructure. Beneficiaries can include state and local governments as well as private persons.

**Work Force Investment Act** – The Department of Labor is to receive \$0.5 billion to be used for research, labor exchange and job training projects that prepare workers for careers in energy efficiency and renewable energy.

**Various Departments Appropriations** – Many departments, including Transportation, Housing and Urban Development, Interior, Defense and Education, as well as the General Services Administration, are receiving appropriations designated for a variety of purposes including capital improvements on buildings that they operate or otherwise have jurisdiction over, energy retrofits, energy efficient vehicle acquisition, greenhouse gas emission management and green building construction or renovation. Funding levels, timing and conditions regarding eligibility vary. The dollars allocated to these programs will total as much as another \$7.5 billion.

**Tax Incentives for Individuals** – The Act includes incentives that could encourage homeowners to invest in wind, solar or geothermal energy systems as well as energy efficient retrofits thus assisting to establish a more vibrant market for these types of services and products. Homeowners making qualified energy efficiency improvements will be entitled to a thirty percent (30%) tax credit. Examples of improvements that might qualify include: solar powered electricity or heat generation units, fuel cell power plant, small wind turbines used to generate electricity and geothermal heat pumps. The Act also makes tax credits available for owners and developers of plug-in electric vehicles, but expands the universe of potentially qualifying vehicles to include low-speed vehicles, motorcycles and three-wheeled vehicles.

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### **SECTION 2. CHANGES TO THE FEDERAL INTERNAL REVENUE CODE**

The following is a summary of some of the significant tax provisions for businesses in the Act. As usual, however, when politics, especially budget politics, enters into the Tax Code (the "Code"), many of these provisions are not as straightforward as they should be and their actual application may not be as advertised. This summary is divided into four parts. Part 1 summarizes the significant business tax provisions with respect to energy; part 2 summarizes the general tax provisions for businesses that are supposed to encourage investment in property and people; part 3 summarizes many of the new tax-exempt bond and other provisions intended to assist state and local governments in infrastructure building; and part 4 describes a new COBRA subsidy provision.<sup>1</sup>

#### **Part One. Energy Related Tax Provisions in the Act for Businesses**

##### **Extension of the renewal energy production tax credit**

The production tax credit (the "PTC") in Code section 45 provides an income tax credit (as part of the general business credit under Code section 38) for the production of electricity from certain qualified renewable energy facilities. Generally, the PTC is equal to 1.5 cents per kilowatt of electricity (adjusted for inflation, but subject to phase-out at certain energy prices) produced from certain qualified facilities, such as wind farms, and sold to unrelated parties. For 2008, the inflation adjusted rate was 2.1 cents per kilowatt hour. The credit is available with respect to electricity produced and sold during a certain specified period depending on the type of facility; wind facilities for example have a 10-year credit period. The PTC has never been a permanent credit and has expired at certain times since it was added to the Code; often having to be retroactively reinstated, which has only increased investment risk and actually curtailed the investment in such facilities by developers, investors and even lenders. Prior to the Act, depending on the nature of the qualified facility, the credit was no longer to be available with respect to facilities placed in service after 2009, 2010 or 2011.

Under the Act, the PTC will now be available for qualifying wind facilities placed in service before 2013 and for qualifying closed-loop biomass facilities, open-loop biomass facilities; geothermal facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic facilities placed in service before 2014.

##### **Election of energy tax credit in lieu of PTC**

Code section 48, part of the investment tax credit under Code section 46 (which is also a general business credit under Code section 38) generally provides an income tax credit equal to 30% of the capitalized

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<sup>1</sup> None of the discussion contained herein is intended to constitute legal or tax advice. Each person should consult his or her own counsel and tax advisor with respect to the impact of the Act on him or her. In accordance with Treasury Circular 230, you are hereby advised that the discussion contained herein (i) may not be used or relied upon by any person to avoid penalties under the Internal Revenue Code of 1986, as amended and similar state laws, (ii) is being used for marketing purposes within the meaning of Circular 230, and (iii) you should consult your own legal and tax advisors with respect to the impact of the Act in light of your own particular circumstances.

costs to acquire or develop certain energy property. Unlike the PTC, the Code section 48 credit is not tied to the production of energy, only the investment in property that may produce certain energy. Solar energy type property is perhaps the most well known energy property for which the energy credit under Code section 48 is available.

Under the Act, in lieu of taking the PTC, with respect to facilities placed in service after 2008, taxpayers can elect to take an upfront 30% energy tax credit for (i) a qualified facility that is a wind facility and is placed in service in 2009, 2010, 2011 or 2012 or (ii) a qualified facility that is a closed-loop biomass facility, open-loop biomass facility; geothermal facility, landfill gas facility, trash facility, hydropower facility, or marine and hydrokinetic facility and is placed in service in 2009, 2010, 2011, 2012 or 2013. The 30% credit applies only to the cost of depreciable tangible property and excludes buildings and their structural components. The Act does not describe the mechanics of the election, but once it is made, the taxpayer will not be able to take a PTC with respect to the same facility for which it has taken the energy credit. Because the energy credit is not tied to production, the election to take the energy credit in lieu of the PTC offers some tax incentives either to those investors who may be more risk adverse or to those projects whose actual successful energy production is more questionable.

#### **Repeal of certain limitations on Energy Tax Credit**

Prior to the Act, the energy tax credit under Code section 48 for qualified small wind facilities was capped at \$4,000 per year. In addition, for purposes of computing the energy tax credit, the tax basis of qualified property was reduced if it was financed in whole or in part by subsidized energy financing or with proceeds from private activity bonds

Under the Act, the \$4,000 small wind facility cap has been eliminated for taxable years beginning after 2008. Similarly, the rule that requires a reduction in tax basis if a facility is financed by subsidized energy financing or with proceeds from private activity bonds has been removed for taxable years beginning after 2008.

#### **Grants in Lieu of PTC or Energy Credit**

For those investors whose particular tax situation prevents them from receiving any economic incentive through a tax credit to invest in qualified facilities that produce renewable energy, the Act provides a new cash incentive to make investments in facilities that would receive PTCs or the Energy Credit.

Under the Act, the Secretary of Treasury is authorized to provide a grant in lieu of a credit to persons who would otherwise be entitled to a PTC or energy tax credit, but only if they (i) place qualified property in service in 2009 or 2010 or (ii) place qualified property in service after 2010 (but before 1/1/2013, 1/1/2014 or 1/1/2017, depending on the property being placed in service) as long as construction begins in 2009 or 2010. The amount of the grant is 30% of the taxpayer's adjusted basis in the case of qualified wind, closed-loop biomass, open-loop biomass, geothermal, landfill gas, trash, hydropower, marine and hydrokinetic, fuel cells, solar, small wind, microturbine, combined heat and power and geothermal heat facilities. For all other qualified facilities, the grant is 10%.

The grant is not included in the taxpayer's gross income, but the taxpayer's tax basis in the qualified facility is reduced by 50% of the amount of the grant. If a facility is disposed of or otherwise ceases to be qualified property within five years of the time that it was placed in service, the grant is subject to recapture.

No grants will be made to governmental entities, 501(c) and 501(a) organizations, qualified issuers under section 54(j)(4) of the Code, or any flow-through entity that has one or more of the foregoing entities as an equity holder.

All applications for a grant must be made by October 1, 2011.

#### **New Credit for investment in Advanced Energy Facilities**

Under section 46 of the Code, the investment tax credit includes rehabilitation credits, energy credits, qualifying advanced coal project credits and qualifying gasification project credits.

The Act adds a new 30% credit, the qualifying advanced energy project credit, to the list of credits that are included in the investment tax credit.

A qualified advanced energy project is a project that re-equips, expands, or establishes a manufacturing facility for the production of property that will be used in connection with renewable energy, fuel cells, microturbines, energy storage, electric grids, carbon sequestration, blending renewable fuels, energy conservation, plug-in electric drive motor vehicles and other approved projects. Credits are available only for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy, and are subject to a \$2.3 billion cap.

#### **Temporary increase in the credit or alternative fuel vehicle refueling property**

A taxpayer may claim a 30-percent tax credit for the cost of installing qualified clean-fuel vehicle refueling property that is either used in the taxpayer's trade or business or that is installed at the taxpayer's principal residence. Prior to the Act, the credit could not exceed \$30,000 per year per location if the refueling property was used in a trade or business or \$1,000 per taxable year per location if the refueling property was installed at the taxpayer's principal residence.

Under the Act, if the refueling property does not relate to hydrogen and is placed in service in 2009 or 2010, the credit increases to 50%, the trade or business cap is increased to \$50,000, and the personal residence cap is increased to \$2,000. If the refueling property does relate to hydrogen and is placed in service in 2009 or 2010, the credit stays at 30%, the trade or business cap is increased to \$200,000, and the personal residence cap is increased to \$2,000.

#### **Application of monitoring requirements to carbon dioxide used as a tertiary injectant**

A credit of \$20 per metric ton is available for qualified carbon dioxide captured by a taxpayer at a qualified facility and disposed of by such taxpayer in secure geological storage (including storage at deep saline formations and unminable coal seams). In addition, a credit of \$10 per metric ton is available for qualified carbon dioxide that is captured by the taxpayer at a qualified facility and used by such taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project.

Under the Act, if carbon dioxide is used as a tertiary injectant, in order to be eligible for the \$10 per metric ton credit, it must also be sequestered by the taxpayer in permanent geological storage. The term "permanent geological storage" has been expanded to include oil and gas reservoirs, along with unminable coal seams and deep saline formations.

## **Part Two. General Businesses Tax Provisions to Encourage Investment in Property and People**

The Act contains a number of provisions available to businesses to encourage the investment in new property and people, to provide some relief with respect to debt workouts, and to assist business cashflow.

### **50% Bonus Depreciation for Additional Year**

The 50% first-year additional bonus depreciation is extended for another year for certain qualified property acquired prior to, and placed in service prior to, January 1, 2010, (except longer production period property and certain transportation property, including certain aircraft can be placed in service as late as December 31, 2010). Qualified property for this purpose is generally property that meets the following four conditions:

- (i) The property either (A) has a recovery period of twenty years or less, (B) is computer software (other than section 197 computer software), (C) is water utility property, or (D) is qualified leasehold improvement property,
- (ii) the original use of the property commences with the taxpayer (generally the property is new rather than used)
- (iii) the property is acquired by the taxpayer after December 31, 2007, and before January 1, 2010, and
- (iv) the property is placed in service by the taxpayer before January 1, 2010.

To continue to help taxpayers who have significant losses in these economic times for which the increased bonus depreciation deduction provides little economic incentive to purchase new property, in lieu of taking the bonus and accelerated depreciation, a taxpayer may make the election under Code section 168(k)(4) to forgo the bonus depreciation on property acquired after January 1, 2009 and before January 1, 2010, and increase the taxpayer's general business credit limitation and/or alternative minimum tax credit limitation by 20% of what would have been the bonus depreciation amount, subject to a cap for any corporation of the lesser of \$30 million or 6% of the business credit carryforward and AMT credit carryforwards for taxable years beginning before January 1, 2006. The amount by which the credit limitations are increased is treated as a refundable credit and thus can generate a cash refund to the taxpayer.

If the Code section 168(k)(4) election is made, the property is depreciated on a straight-line method for both regular tax and AMT purposes. The Code section 168(k)(4) election became law last year and applied, if the election was made, with respect to property acquired and placed in service after March 31, 2008, and before January 1, 2009. A taxpayer who did not make an election with respect to 2008 property can make it now for the new qualified property acquired in 2009, or, if the taxpayer made the election with respect to 2008 acquired property, the taxpayer may forgo the election with respect to the property acquired in 2009. Thus, the new law is intended to give taxpayers significant flexibility. The IRS has provided guidance with respect to the Code section 168(k)(4) election and how to make it in Revenue Procedures 2008-65 and 2009-16, which will now need to be updated for the Act changes. Given the election requirements, taxpayers need to pay particular close attention to these extended bonus depreciation provisions to maximize their tax benefits resulting from increased investment.

**Increased 179 Expense Deduction Continues**

Under Code section 179, a taxpayer may elect, in lieu of depreciating certain property, to deduct the first \$250,000 of the cost of such acquired property. The \$250,000 amount is reduced by the cost of qualifying property purchased in the year that exceeds \$800,000. Further, the Code section 179 deduction cannot exceed the amount of taxable income derived in an active trade or business for the year the deduction is taken. The \$250,000 amount and \$800,000 threshold, which were in place for 2008, were to revert back to \$125,000 and \$500,000 amounts respectively in 2009 (although indexed for inflation), but the Act keeps the higher amounts for another year.

**Job Credits for Hiring Unemployed Veterans and Disconnected Youth**

The Act adds another two classes of workers for which an employer may take a Code Section 51, work opportunity credit. These two new classes are (i) unemployed veterans who had been discharged from the Armed Forces within 5 years before the hiring date and had been receiving at least 4 weeks of unemployment compensation during the 1-year period ending on the hiring date and (ii) workers aged 16 to 25 who had not been in school and had not been employed during the six-month period preceding the hiring date and have been certified by the state employment agency as lacking a significant number of basic skills.

As the Code section 51 credit is part of the general business credit under Code section 38, the impact of the Code section 168(k)(4) election potentially augments this additional tax credit.

**Increased exclusion for commuter transit benefits**

Qualified transportation fringe benefits provided by an employer are excluded from an employee's gross income for income tax purposes and from the employee's wages for payroll tax purposes. Qualified transportation fringe benefits include parking, transit passes, vanpool benefits, and qualified bicycle commuting reimbursements. Prior to the Act, for 2009 up to \$230 per month of employer-provided parking was excludable from income, and up to \$120 per month of employer-provided transit and vanpool benefits were excludable from income. For future years, both amounts are indexed annually for inflation.

Under the Act, for 2009 and 2010, the exclusion from income for employer-provided transit and vanpool benefits is increased to equal the exclusion for employer-provided parking.

**Limited Increase in NOL Carryback Period**

Generally, under Code section 172 net operating losses (NOLs) may be carried back two taxable years and carried forward 20 taxable years. Certain types of losses (*e.g.*, losses resulting from federally declared disaster areas or product liability losses) have longer carryback periods.

The Act allows an "eligible small business" to elect to carryback a NOL incurred in a taxable year ending in 2008 or, in lieu thereof, a taxable year beginning in 2008 to any of the previous five taxable years. This is a one-time election and is available for only one NOL year. Technically, the election is made only if the taxpayer wants to go back more than two years and less than six, because the general two-year period remains. An "eligible small business" for this purpose means a corporation, partnership or sole proprietorship (if it had been taxed like a corporation) which for the year in which the NOL was occurred had averaged over the 3-year period ending with the loss year less than \$15 million of average annual gross receipts.

### **Temporary shortening of the recognition period for built-in gains of an S corporation**

In general, S corporations do not pay a corporate level tax. If, however, a C corporation elects to become an S corporation at a time that it has net built-in gains, it is subject to a corporate level built-in gains tax if it sells or transfer the assets to which the built-in gains are attributable, but only if the sale or transfer takes place within a ten-year recognition period. The ten-year recognition period begins on the date of the conversion from C status to S status or the acquisition of assets from a C corporation in a tax-free transaction (*e.g.*, a reorganization).

Under the Act, no built-in gains tax is imposed on sales or transfers in 2009 or 2010 if seven years of the S corporation's ten-year recognition period elapsed prior to the beginning of the year during which the sale or exchange is to take place.

### **Additional Benefits for Small Business Stock**

To encourage new equity investments in small companies, Code section 1202 allows individuals to exclude 50% of the gain from the sale or exchange of stock held at least five years that was acquired at original issuance from a small business company. The maximum amount that can be excluded by any individual with respect to the stock of one company is the lesser of 10 times the individual's basis or \$10 million (\$5 million for a married individual filing separately). Generally, a small business company is a C corporation engaged in an active trade or business having gross assets of less than \$50 million.

The Act increases the deduction to 75% with respect to small business company stock acquired after February 17, 2009 and before January 1, 2011.

### **Estimated Tax Payments for Small Business Owners and Partners**

Generally, individuals who are sole proprietors, partners in partnerships and shareholders in S corporations make quarterly estimated tax payments because they may not have sufficient wage withholding to account for their total federal tax liability. Individuals generally are subject to an interest charge in the form of the estimated tax penalty if the amount of estimated tax payments made in the year are less than the lesser of 90% of the tax ultimately due for that year or 100% of the previous year's tax liability (110% of the previous year if the individual's adjusted gross income for the previous year exceeded \$150,000).

The Act provides that for 2009, a qualified individual need only make estimated tax payments equal to 90% of the tax liability shown on the individual's return for 2008. A qualified individual for this purpose means any individual if (i) the adjusted gross income shown on the return for such preceding year (generally 2008) is less than \$500,000 (\$250,000 if married filing separately), and such individual certifies that more than 50% of the gross income shown on such previous year's return was income from a "small business." A small business is defined as a trade or business the average number of employees of which was less than 500 for the calendar year ending with or within the preceding taxable year of the individual.

### **Cancellation of Debt Income Relief and Deferral**

Generally, unless a taxpayer is in bankruptcy or insolvent, the taxpayer must generally recognize and pay income tax on cancellation of debt income ("CODI"), including CODI resulting from the significant modification of a debt instrument, an actual exchange of a new debt instrument for an old debt instrument, a debt instrument contributed to the capital of the corporate borrower by its shareholder, or the reacquisition of a debt instrument for cash or property at an amount or value less than its adjusted

issue price by either the debtor itself or a person related to the debtor. There are other CODI exclusions under the Code currently available with respect to certain types of debt such as mortgage indebtedness on a personal residence.

The Act, however, grants an additional CODI deferral benefit. The Act provides that with respect to a "debt reacquisition" of an "applicable debt instrument" giving rise to CODI in 2009, the debtor can elect to defer the recognition of such income until the fifth taxable year following 2009 and then include the CODI in taxable income 20% per year for the succeeding five years. If the debt reacquisition occurs in 2010, the debtor can elect to defer the CODI until the fourth taxable year following 2010 and then include the CODI in taxable income 20% per year for the succeeding five years. For this purpose, an applicable debt instrument is any debt instrument issued by a C-corporation or any other person in connection with the conduct of a trade or business, and a debt reacquisition includes the complete forgiveness of the indebtedness by the holder of the debt instrument, an acquisition of the debt instrument for cash by the debtor or a related person, a debt-for-debt exchange (including a deemed exchange resulting from a significant modification), an exchange of debt for corporate stock or a partnership interest, and debt contributed to capital of a corporation. Unfortunately, the statute on its face does not address if the deferral is available when the debt is extinguished or acquired for property other than cash, a new debt instrument, stock or a partnership interest, such as in a deed in lieu transaction for real estate.

If, as part of a debt-for-debt exchange, the new debt instrument has original issue discount ("OID"), the electing debtor must defer its deduction for the OID until the debtor starts taking the CODI into taxable income, and the amount of OID that can be deducted is limited to the amount of the CODI recognized.

This deferral election is available even if the taxpayer is in bankruptcy or insolvent and would have otherwise been able to exclude the CODI from taxable income but had to reduce its favorable taxable attributes instead. This deferral election also is available for partnerships, S corporations, and other pass through entities. Although the benefit of the CODI deferral will go to the partners of the partnership or the shareholders of the S-corporation, the partnership or S-corporation must make the election. Therefore, partners and S Corporation shareholders need to communicate with managers of such entities to make sure the election, if desired, is made.

The deferral ends immediately, however, in the taxable year in which the debtor is liquidated (including in bankruptcy), ceases business, or sells substantially all of its assets. The sale or exchange or redemption of a partnership interest or share of S corporation stock constitutes a sale of assets for this purpose. Presumably, the Treasury Department, which was instructed to provide guidance on this provision, will clarify that the sale of a partnership interest or share of S corporation stock only ends the deferral of the selling partner or S corporation shareholder and not impact the tax consequences of the those partners or shareholders who do not sell.

#### **AHYDO Relief**

Generally, a C-corporation borrower's ability to deduct OID on an applicable high yield debt obligation (AHYDO) is limited until the OID is actually paid in cash, and, in certain cases, a portion of the OID and interest may not be deductible at all. A high-yield debt obligation is generally a debt instrument that has a yield in excess of the applicable federal rate plus 5%, has a term of more than five years, is issued by a C corporation and has "significant original issue discount." Although the AHYDO provisions by their terms only apply to a C corporation, they may also limit the interest deductions of C corporations that are partners or members in partnerships or LLCs that have issued AHYDO instruments. A debt instrument

has significant original issue discount if the aggregate amount to be included in gross income for periods before the close of any accrual period ending after the fifth anniversary of the issue date exceeds the sum of the aggregate amount of interest required to be paid before the close of such accrual period and the product of the issue price and the yield to maturity of debt instrument. Many credit agreements allow borrowers to make a payment at the time of the first accrual period after the fifth anniversary to pay the accrued OID to prevent the instrument from being a AHYDO and potentially disallowing or deferring the borrower's interest deduction.

The Act generally calls off the AHYDO rules for debt instruments issued between September 1, 2008, and December 31, 2009, in exchange (including a deemed exchange resulting from a significant modification) for another debt instrument that was not a AHYDO. This rule only applies if the debt instrument is held by a person not related to the borrower and the debt instrument does not have contingent interest, such as equity kicker interest.

### **Repeal of Notice 2008-83**

In an effort to provide support to financial institutions for which there was a high risk of being put into receivership absent a takeover by a more secure financial institution or the receipt of new equity capital, the Treasury Department issued Notice 2008-83, which provided that bad debt deductions of financial institutions occurring after an ownership change within the meaning of Code section 382 would not be treated as built-in losses or deductions that would be limited by Code section 382 even though most of the debt's loss in value (although not realized) had occurred prior to the ownership change. The Treasury Department was clearly concerned that Code section 382 would act as a disincentive for new capital to be invested in suffering banks or for stronger banks to acquire suffering banks as the ability for the suffering bank to actually deduct for income tax purposes a bad debt on loans existing before the ownership change would be severely reduced by the Code section 382 limitation. Congress, however, thought Treasury Department did not have authority for Notice 2008-83 and had been concerned that the Notice had been issued to support certain specific bank acquisitions.

The Act expressly repeals Treasury Notice 2008-83 for an ownership change occurring after January 16, 2009, unless the ownership change occurs either pursuant to a written binding contract that was in place on or before January 16, 2009, or pursuant to a written agreement entered into on or before January 16, 2009, for which there was either a public announcement or SEC filing on or before such date.

### **Protection for Ownership Change from Government Investment**

The Act contains additional relief from Code section 382 for taxpayers receiving government loans or credit commitments. The Act provides that an ownership change occurring as part of a restructuring plan required for a loan or commitment for line of credit from the Treasury Department under the Emergency Economic Stabilization Act of 2008 (e.g., GM ) will not constitute an ownership change for Code section 382 purposes provided that no person (other than a VEBA) ends up owning 50% or more of the stock of the loss corporation.

### **Grants in lieu of low-income housing credits**

A low-income housing credit may be claimed over a ten-year period for qualifying rental properties, but only if the owner of the building receives a credit allocation from the relevant state or local housing agency. A project that also receives tax-exempt financing subject to the private activity bond volume limit does not require a credit allocation.

Under the Act, the Secretary of the Treasury will make a grant available to each state in an amount based on 8.5 times a number based on the state's low income credit allocations. Each state may make subawards to owners of facilities that would have otherwise been eligible for low-income house credits. Each state housing credit agency is required to perform management functions to ensure compliance with low-income housing credit rules, and failure to comply will result in recapture of the grant.

Recipients of subawards will be subject to the same income limitations and use restrictions as recipients of low-income housing credits. The grant is not included in the owner's gross income, and the owner's tax basis in the qualified facility is not reduced by the amount of the grant.

No grants will be made to governmental entities, 501(c) and 501(a) organizations, qualified issuers under section 54(j)(4) of the Code, or any flow-through entity that has one or more of the foregoing entities as an equity holder.

All applications for a grant must be made by October 1, 2011.

#### **Increase in the new markets tax credit**

The Act increases the new markets tax credit limitation for each of 2008 and 2009 from \$3.5 billion to \$5 billion. The increase is for 2008 to qualified community development entities which (i) submitted an allocation application for 2008, and (ii) either did not receive an allocation, or received an allocation in an amount less than the amount requested.

#### **Part Three. Improved Marketability for Tax-Exempt Bonds, New Bonds and Assistance to Tax Assistance to State and Local Governments for Infrastructure**

The Act contains a number of provisions to help state and local governments, including provisions that are designed to encourage the marketability of tax-exempt bonds, provisions that add new categories or amounts of tax-exempt bonds to build infrastructure, and provisions that grant tax credits in lieu of the tax-exempt interest thereof. The following contains a summary of a number of these provisions.

#### **De Minimis Safe Harbor for Code section 265(b) purposes**

Code section 265 generally precludes a taxpayer from deducting interest associated with indebtedness that is treated as being used to acquire or carry tax-exempt bonds. Code section 265(b) automatically disallows a portion of a financial institution's interest expense based on an allocation formula.

The Act provides that with respect to tax-exempt bonds issued during 2009 and 2010, Code section 265(b) shall not apply. This rule only applies with respect to such tax-exempt bonds to the extent they do not exceed more than 2% of the financial institution's total average adjusted basis in its assets. Furthermore, the Act increases the dollar cap to constitute a qualified small issuer, whose general government type bonds (*i.e.*, not private activity type bonds) are not subject to the limitations of Code section 265(b). A qualified small issuer is generally a state or local government authority that does not issue more than \$10 million of general government bonds in any calendar year. The Act increases the \$10 million amount to \$30 million with respect to bonds issued in 2009 or 2010.

### **AMT Preference Exclusion**

Although interest on a qualified private activity bond is excluded from a taxpayer's gross income for regular tax purposes, it is treated as an item of preference for alternative minimum tax purposes (AMT) and, thus, needs to be added back into income when determining AMT.

The Act provides that interest on private activity bonds issued in 2009 or 2010, will not be treated as a preference item for AMT purposes. A bond issued in 2009 or 2010 to refund a prior bond is generally not treated as being issued for this purpose. This provision of the Act, thus, is designed to encourage the loaning of money for new projects. However, if the new bond refunds a prior bond that was issued between January 1, 2004, and December 31, 2008, the refunding bond still qualifies for this provision.

### **Increase in the maximum amount of new clean renewable energy bonds**

New clean renewable energy bonds ("New CREBs") may be issued by qualified issuers to finance qualified renewable energy facilities. "Qualified renewable energy facilities" are facilities that (i) qualify for the tax credit under section 45 (other than Indian coal and refined coal production facilities) determined without regard to the placed-in-service date requirements, and (ii) are owned by a public power provider, governmental body, or cooperative electric company. "Qualified issuers" includes: (1) public power providers; (2) governmental bodies; (3) cooperative electric companies; (4) certain not-for-profit electric utilities; and (5) clean renewable energy bond lenders. Prior to the Act, the national limitation for New CREBs was \$800 million. The Act increases the national limitation by \$1.6 billion.

### **Increase in the maximum amount of qualified energy conservation bonds**

Qualified energy conservation bonds may be used for qualified conservation purposes. A "qualified conservation purpose" includes a variety of energy reduction expenditures, *e.g.*, facilities construction, research, battery technology, mass commuting, and public education. Prior to the Act, there was a national limitation on qualified energy conservation bonds of \$800 million.

Under the Act, the national limitation has been increased by \$2.4 billion. The Act also expands what is eligible for qualified energy conservation bonds. For example, states may now issue qualified energy conservation bonds to finance loans or grants to individual homeowners to retrofit existing housing.

### **Temporary expansion of availability of IDBs to facilities manufacturing intangible property**

Qualified small issue bonds (or industrial development bonds or small issue IDBs) are tax-exempt bonds issued by state and local governments to finance private business manufacturing facilities. Such bonds are subject to borrowing limits. In general, no more than \$1 million of small-issue bond financing may be outstanding at any time for a business property located in the same municipality or county. Generally, the \$1 million limit may be increased to \$10 million if all of the business capital expenditures in the municipality or county are counted toward the limit. The \$10 million limit can be increased to \$20 million if the business is engaged in the manufacturing or production of tangible personal property

Under the Act, for bonds issued after the date of enactment and before 2011, businesses that are engaged in the creation or production of intangible property are also eligible for the \$20 million cap.

### **Recovery zone economic development bonds and recovery zone facility bonds**

The Act creates two new categories of bonds—recovery zone economic development bonds and recovery zone facility bonds, all of which must be issued before 2011. There is a national recovery zone economic development bond limitation of \$10,000,000,000 and a national recovery zone facility bond limitation of

\$15,000,000,000. Subject to a minimum allocation to each state, the limitation will be allocated among the states in the proportion that each state's 2008 state employment decline bears to the aggregate of the 2008 state employment declines for all states.

The term 'recovery zone' means (i) any area designated by the issuer as having significant poverty, unemployment, rate of home foreclosures, or general distress, (ii) any area designated by the issuer as economically distressed by reason of the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990, and (iii) any area for which a designation as an empowerment zone or renewal community is in effect.

The interest received in connection with both categories of bonds will be fully taxable to the holder, but the issuer will be entitled to a tax credit equal to 45% of each interest payment and thus can raise the interest rate offered to holders as a result of receiving this subsidy.

### **Intercity Rail Facility Bonds**

Under Code section 142(i), a state or local government private activity bond issued to fund a high speed intercity rail service can qualify as an exempt facility bond, the interest on which is excludible from gross income for regular tax purposes (and AMT purposes if the bond is issued in 2009 or 2010). To meet the high speed requirement, the Code originally required that the rail service operate at speeds in excess of 150 mph. The Act lowers the requirement to only "being capable of obtaining a maximum speed in excess of 150 mph."

### **Tribal economic development bonds**

The Act authorizes the issuance of tribal economic development bonds, which will qualify as tax-exempt as if they had been issued by a state. The Secretary of Treasury will consult with the Secretary of Interior to allocate a \$2 billion limitation among Indian tribal governments.

Bond proceeds may not be used for any building in which class II or class III gaming is conducted or for any facility located outside the Indian reservation.

### **Qualified school construction bonds**

The Act authorizes the issuance of qualified school construction bonds. The bonds are to be used for the construction, rehabilitation, or repair of a public school facility or for the acquisition of land on which such a facility is to be constructed and are tax credit bonds.

There is a national limitation of \$11 billion for 2009 and \$11 billion for 2010, and zero for all following years except for carryovers of any unused limitations from 2009 and 2010.

### **Extension and expansion of qualified zone academy bonds**

The Act extends and expands the qualified zone academy bond program by increasing the national limitation for 2009 from \$400 million to \$1.4 billion and by creating a new national limitation of \$1.4 billion for 2010.

### **Build America Bonds**

Unless the issuer elects otherwise, holders of Build America Bonds are entitled to a tax credit equal to 35% of the interest on an otherwise tax-exempt bond that instead is treated as a "taxable governmental bond." A taxable governmental bond is an obligation (other than a private activity bond) if the interest on

such obligation would be (but for the Act) excludable from gross income under section 103 of the Code. As the holder of a taxable governmental bond receives interest payments over the life of the bond, subject to certain limitations, the holder will be entitled to a tax credit equal to 35% of each interest payment as it is received.

Build America Bonds must be issued before 2011.

In the case of a qualified Build America Bond that is issued before 2011, the issuer of the bond shall be allowed a credit, in lieu of the credit to the holder, with respect to each interest payment under such bond that will be paid by the Secretary of the Treasury to the issuer. Qualified bonds are Build America Bonds that meet a capital expenditure test.

#### **Regulated investment companies allowed to pass-thru tax credit bond credits**

Certain regulated investment companies (generally mutual funds) that hold tax credit bonds may elect to forego the credit on such bonds and pass the credit through to their shareholders.

#### **Application of prevailing-wage rules to projects financed with tax-favored bonds**

Federal prevailing-wage requirement will apply to projects financed with clean renewable energy bonds (section 54C of the Code), qualified energy conservation bonds (section 54D of the Code), qualified zone academy bonds (section 54E of the Code), qualified school construction bonds (section 54E of the Code), or recovery zone economic development bonds (section 1400U-2 of the Code).

#### **Part Four. Special COBRA Provision**

The Code requires group health plans maintained by employers to offer certain individuals the opportunity for a specified period of time to continue to participate in the group health plan after certain terminations of employment. This requirement is commonly known as COBRA. Failure to comply with the COBRA provisions can result in health plans and employers being subject to an excise tax of \$100 for each day of noncompliance. Generally, the terminated individual is required to pay the full cost of the continuation coverage, which because of permitted administration fees can be as great as 102% of the premiums the employer was paying.

The Act requires that with respect to individuals who are involuntarily terminated between September 1, 2008, and December 31, 2009, the employer must treat the terminated individual as paying the applicable premium if the individual pays 35% of the premium. Employers are required to provide notice of this new benefit. This benefit can only continue for nine months. The employer will be entitled to reduce its payroll taxes by the amount of the subsidy provided to the terminated employees as the result of this provision. The benefit will not be available with respect to individuals who have modified adjusted gross incomes in excess of \$145,000 and \$290,000 for joint filers in the year benefits are received. If the individual's modified adjusted gross income exceeds these thresholds, the individual will be required to pay the subsidy back through an increase in the individual's federal income tax liability for the year the benefits are received. Individuals will be able to elect to waive the right to the subsidy.

Guidance is required to be provided by the Treasury Department within thirty days of the date of enactment. The IRS has already issued a new Form 941 (lines 12 and 12a) in order for employers to take credit for the subsidy payments against their payroll taxes and the Department of Labor has set up a special website to provide information on this new COBRA provision ([www.dol.gov/ebsa/COBRA.html](http://www.dol.gov/ebsa/COBRA.html)).

## **DOLLARS AVAILABLE FOR PRIVATE SECTOR IN FEDERAL STIMULUS BUT BE MINDFUL OF IMPORTANT DETAILS**

### **SECTION 3. INFORMATION TECHNOLOGY IN THE HEALTHCARE SECTOR AND OTHER MISCELLANEOUS PROGRAMS.**

#### **Health Information Technology for Economic and Clinical Health Act (HITECH Act)**

A few decades ago HIPAA revolutionized health care law in the United States. It pushed what had historically been within the sphere of health care providers, their patients and varying state laws into the realm of national solutions. The new Health Information Technology for Economic and Clinical Health Act (or HITECH Act) is another giant leap in the same direction. Clothed in words like privacy, security and interoperability, it is based on a basic truth. If we want the ability to whisk complicated data around the country without data corruption or loss, with full accessibility, while fully protecting privacy, and at a minimum cost, then we do not have the luxury of a hundred solutions. We can only adopt a few, and they must all comply with a single national standard. The HITECH Act is an attempt to create that single standard.

The methods employed by the HITECH Act to achieve the desired result are multi-faceted. It taps into existing work and organizations to take advantage of their successes and mistakes, yet it also broadens the range and number of participants in the policy making process. It makes use of standards created under the HITECH Act voluntary, yet the penalties for losing data are greater if the standard is not used. Grants and loans are available, but the transition will still impose a cost on virtually everyone in the health care community. The new Office of the National Coordinator for Health Information Technology has set some very high goals for the health care community. It has a broad range of carrots and sticks to accomplish those goals, but the heavy lifting will remain in the hands of providers, and it is they who will ultimately determine the success or failure of the initiative.

The HITECH Act also expands the reach of federal regulation, and it kicks in on an accelerated pace. HIPAA applied primarily to providers, plans and payers and only indirectly to their business associates. The HITECH Act applies to same the people that HIPAA did, but it also applies directly to business associates. It also applies to people who keep health information of others, but who are not part of the traditional health care community (*e.g.*, a sports web site that tracks a marathoner's blood pressure). It contains a series of deferred effective dates for actual implementation, but for those of us who remember the periods over which HIPAA phased in, the new effective dates are aggressive. The HITECH Act is a large step, but based on the numbers and ranges of required reports and studies, it will not be the last one. As we move from 8 1/2 x 11 to XML, a lot more players are joining the ride, and the ride is getting a lot faster.

The goals of the HITECH Act are lofty. The pace is quick. The hoped-for benefits are large. And, the transition will be hard. Nascent vendors and entrenched organizations are already jostling for position in what they all hope will be a bonanza for the winners. Those who think that the HITECH Act is only a technology law are wrong. It is a full-fledged health care law that reaches into virtually every crevice of health care.

## **Detailed explanation**

### **The National Coordinator**

The HITECH Act establishes a new Office of the National Coordinator for Health Information Technology and a new position, the National Coordinator, within the Department of Health and Human Services. The National Coordinator's primary responsibility is to oversee the development of the infrastructure that will support electronic health records (eHRs).

The almost insurmountable combined goals for the planned infrastructure include protecting privacy, providing security, achieving more quality, minimizing costs, giving better access to information, easing public input, meeting research needs, improving early detection, increasing competition, reducing of health care disparities, maximizing public understanding, and meeting unique needs of vulnerable populations.

### **Chief Privacy Officer**

Within a year, the Secretary must appoint a Chief Privacy Officer, who will advise the National Coordinator on privacy, security, and data stewardship of electronic health information and will coordinate with other federal agencies, state and regional bodies, and foreign countries.

### **HIT Policy Committee**

The HITECH Act establishes a HIT Policy Committee that is expected to make policy recommendations relating to various technology issues, including those that relate to privacy, security, accounting for disclosures, collection of demographic data, biosurveillance, drug safety, self-service technologies, telemedicine, home health care, reduction of medical errors, unique issues relating to children and other vulnerable populations, a patient's access to his or her own information, and caregiver access to information, as well as any other issues raised by the Committee relating to the improvement of the quality and efficiency of health care.

The membership of the Committee will include a broad range of experts and interested parties, both inside and outside various sectors of the health care community.

### **HIT Standards Committee**

The HITECH Act also establishes a HIT Standards Committee to recommend standards, implementation specifications, and certification criteria for eHRs. The Committee will, as appropriate, provide for the testing of such standards and specifications by NIST.

The membership of the HIT Standards Committee will reflect providers, ancillary healthcare workers, consumers, purchasers, health plans, technology vendors, researchers, relevant federal agencies, and individuals with technical expertise.

### **Adoption of recommendations, standards, specifications, and criteria**

Not later than ninety days after the date of receipt of endorsed standards, implementation specifications, or certification criteria, the Secretary, in consultation with representatives of other relevant federal agencies, must jointly review them and determine whether or not to propose their adoption.

**Voluntary application**

Except when it is contracting with federal agencies, a private entity is not required to adopt or comply with a standard or implementation specification adopted under the HITECH Act.

**Federal health information technology**

If the eHR needs and demands of providers are not being adequately met through the marketplace, the National Coordinator will undertake the development and updating of a eHR technology and make it available.

**ONCHIT and AHIC Successor, Inc.**

ONCHIT.—The functions, personnel, assets, and liabilities, and administrative actions applicable to the National Coordinator for Health Information Technology appointed under Executive Order No. 13335 and the Office of such National Coordinator will be transferred to the Office of the National Coordinator.

AHIC Successor, Inc.— The HITECH Act should not be construed as prohibiting the AHIC Successor, Inc. doing business as the National eHealth Collaborative from modifying its charter, duties, membership, and any other structure or function that the Secretary can recognize it as the HIT Policy Committee or the HIT Standards Committee.

**HIPAA standards**

The HITECH Act may not be construed as having any effect on the authorities of the Secretary under HIPAA privacy and security law to ensure that the health information technology standards and implementation specifications adopted under the HITECH Act take HIPAA requirements into account.

**Coordination of federal activities**

As each federal agency implements, acquires, or upgrades its health information technology systems, it shall utilize, where available, health information technology systems and products that meet standards and implementation specifications adopted under the HITECH Act.

**Federal contracts with private entities**

Each agency shall require in its contracts or agreements with health care providers, health plans, or health insurance issuers that as each implements, acquires, or upgrades health information technology systems, it must utilize systems and products that comply with the HITECH Act.

**Study and reports**

Within two years and annually after that, the Secretary must submit a report to the appropriate Senate and House committees that describes actions taken, barriers to adoption; and recommendations to achieve full implementation.

The Secretary of Health and Human Services must also prepare a study that examines methods to create efficient reimbursement incentives for improving health care quality in federally qualified health centers, rural health clinics, and free clinics.

The Secretary of Health and Human Services must also provide a study of matters relating to the potential use of new aging services technology to assist seniors, individuals with disabilities, and their caregivers.

**NIST testing**

In coordination with the HIT Standards Committee, NIST will test standards and implementation specifications.

**Research and development programs**

NIST, in consultation with NSF and other appropriate federal agencies, will establish a program of assistance to institutions of higher education (or consortia which may also include nonprofit entities and federal government laboratories) to establish multidisciplinary Centers for Health Care Information Enterprise Integration.

Research areas for the Centers may include human-systems interfaces; voice-recognition systems; software that improves interoperability and connectivity; software dependability, impact on quality and productivity; health information enterprise management; security and integrity; and technology to reduce medical errors.

**Immediate funding**

The Secretary is to invest in the infrastructure necessary to allow for and promote the eHRs for every individual in the United States and may invest funds through the different agencies with the right expertise, such as the Office of the National Coordinator for Health Information Technology, the Health Resources and Services Administration, the Agency for Healthcare Research and Quality, the Centers of Medicare & Medicaid Services, the Centers for Disease Control and Prevention, and the Indian Health Service.

**Implementation assistance**

To assist providers to adopt, implement, and use eHR technology, the Secretary, acting through the Office of the National Coordinator, will establish a health information technology extension program. The Secretary is to create a Health Information Technology Research Center (the "Center") to provide technical assistance and to develop or recognize best practices to support eHRs in compliance with the HITECH Act.

In addition, the Secretary is to provide assistance for the creation and support of regional centers ("regional centers") to provide technical assistance and disseminate best practices and other information learned from the Center. Regional centers may be affiliated with US-based nonprofit organizations that apply for and are awarded financial assistance.

The Secretary may provide financial support to any regional center for a period not to exceed four years.

**State grants**

The Secretary, acting through the National Coordinator, shall establish a program to facilitate and expand the electronic movement and use of health information among organizations according to nationally recognized standards. The Secretary may award a grant to a state or a qualified state-designated entity that submits an application to the Secretary.

**Competitive grants to states and Indian tribes**

The National Coordinator may award competitive grants to eligible entities for the establishment of programs for loans to health care providers to implement eHRs. An "eligible entity" is a state or an Indian tribe that timely and properly submits an application, and a strategic plan, commits to set up a

loan fund; agrees to lend only to complying health care providers, and provides matching funds equal to not less than \$1 for each \$5. The Secretary may not make such an award prior to January 1, 2010.

#### **Demonstration program**

The Secretary may award grants to carry out demonstration projects to develop academic curricula integrating certified eHR technology in the clinical education of health professionals. To be eligible, an entity must be a school of medicine, osteopathic medicine, dentistry, or pharmacy, a graduate program in behavioral or mental health, or any other graduate health professions school; a graduate school of nursing or physician assistant studies; a consortium of two or more of the foregoing schools or an institution with a graduate medical education program; must provide for the collection of data regarding the effectiveness of the demonstration project; and must provide matching funds.

An eligible entity may not use amounts received under such a grant to purchase hardware, software, or services.

#### **Information technology professionals**

The Secretary, in consultation with the Director of the NSF, shall provide assistance to institutions of higher education (or consortia thereof) to help them establish or expand medical health informatics education programs.

#### **Required reports**

The Secretary may require that an entity receiving assistance submit a report to the Secretary, not later than the date that is one year after the date of receipt of such assistance

#### **Application of security provisions and penalties to business associates; annual guidance**

The HIPAA security regulations that have applied to covered entities under HIPAA now also apply to a business associate of a covered entity. The additional security requirements imposed by the HITECH Act will apply to both covered entities and their business associates and must be incorporated into the business associate agreement between the business associate and the covered entity.

If a business associate violates any of the security provisions described in the preceding paragraph or in HIPAA, the same penalties will apply to the business associate that apply to a covered entity if it violates the same security provision.

For the first year beginning after the date of the enactment of the HITECH Act and annually thereafter, the Secretary will issue guidance on the most effective and appropriate technical safeguards to use in carrying out the security provisions described in the preceding two paragraphs and the security standards that were in effect immediately before the enactment of the HITECH Act.

#### **Notification in the case of breach**

If a covered entity suffers a breach of unsecured protected health information, it is required to notify each individual whose health information has been, or is reasonably believed to have been, compromised. If a business associate suffers a breach unsecured protected health information, it is required to notify the covered entity of the breach.

Unless a law enforcement officer requires otherwise, the required notifications must be made without unreasonable delay and in no case later than sixty calendar days after discovery of the breach. The notice

to the individual whose information has been compromised must be by first-class mail unless there is insufficient information, in which case a substitute method must be found.

Notice must also be provided to prominent media outlets serving a state or jurisdiction, following the discovery of a breach if the unsecured protected health information of more than five hundred residents of the state or jurisdiction is, or is reasonably believed to have been, compromised. Notice must also be provided to the Secretary. Not later than the date that is sixty days after enactment of this Act, the Secretary shall issue (and annually update) guidance specifying the technologies and methodologies that render protected health information unusable, unreadable, or indecipherable to unauthorized individuals.

The Secretary of Health and Human Services is to promulgate interim final regulations by not later than 180 days after enactment of the HITECH Act.

These provisions shall apply to breaches that are discovered on or after the date that is thirty days after the date of publication of such interim final regulations.

#### **Privacy education**

Not later than six months after the date of the enactment of the HITECH Act, the Secretary shall designate an individual in each regional office of the Department of Health and Human Services to offer guidance and education to covered entities, business associates, and individuals on their rights and responsibilities related to federal privacy and security requirements for protected health information.

Not later than twelve months after the date of the enactment of the HITECH Act, the Office for Civil Rights within the Department of Health and Human Services shall develop and maintain an education initiative to enhance public transparency regarding the uses of protected health information

#### **Application of privacy provisions and penalties to business associates**

If a business associate obtains or creates protected health information pursuant to a written contract described in the HIPAA regulations, the business associate may only use and disclose such information in compliance with each applicable requirement of the HIPAA regulations.

All privacy requirements imposed on covered entities are also imposed on business associates and must be incorporated into the business associate agreement.

Section 164.504(e)(1)(ii) of title 45, Code of Federal Regulations shall apply to a business associate in the same manner that it applies to a covered entity.

#### **Restrictions on disclosures; access to information**

If an individual requests under the HIPAA regulations that a covered entity restrict the disclosure of the protected health information of the individual, the covered entity must comply with the requested restriction if the disclosure is to a health plan for purposes of carrying out payment or health care operations (and not for purposes of carrying out treatment) and the protected health information pertains solely to a health care item or service for which the health care provider involved has been paid in full.

Subject to the timely issuance of guidance, a covered entity shall be treated as being in compliance with the HIPAA regulations, with respect to the use, disclosure, or request of protected health information,

only if the covered entity limits such protected health information, to the extent practicable, to the limited data set or, if needed by such entity, to the minimum necessary to accomplish the intended purpose.

Not later than eighteen months after the date of the enactment of the HITECH Act, the Secretary shall issue guidance on what constitutes "minimum necessary."

The Secretary will promulgate regulations on what information shall be collected about disclosures, not later than six months after the date on which the Secretary adopts standards on accounting for disclosure described in the HITECH Act.

If a covered entity acquired an electronic health record as of January 1, 2009, the new accounting requirements shall apply to disclosures made by the covered entity from such a record on and after January 1, 2014.

If a covered entity acquired an electronic health record after January 1, 2009 (extendable by the Secretary), the accounting requirements shall apply to disclosures made by the covered entity from such record on and after the later of January 1, 2011(also extendable by the Secretary); or the date that it acquires the record.

Subject to certain statutory exceptions, a covered entity or business associate shall not directly or indirectly receive remuneration in exchange for any protected health information of an individual unless the covered entity obtained a valid authorization from the individual.

Not later than eighteen months after the date of enactment of the HITECH Act, the Secretary shall promulgate regulations to carry out the accounting and disclosure requirements, and they shall apply to exchanges occurring on or after the date that is six months after the date of the promulgation of final regulations.

If a covered entity uses or maintains an eHR on an individual the individual will have a right to obtain a copy in an electronic format and, if the individual chooses, to direct the covered entity to transmit the copy directly to someone else. The copying fee may not be greater than the labor costs incurred when responding to the request.

#### **Breach notification requirement for vendors and other non-HIPAA covered entities**

Each vendor of personal health records, following the discovery of a breach and each certain third parties, following the discovery of the breach of security of information that is obtained through a product or service provided by such entity, shall notify both the individual and the Federal Trade Commission.

A third party service provider that provides services to a vendor of personal health records shall, following the discovery of a breach, notify the vendor or entity of such breach.

A violation of the notification requirements shall be treated as an unfair and deceptive act or practice. To carry out this section, the FTC shall promulgate interim final regulations by not later than the date that is one hundred eighty days after the date of the enactment of the HITECH Act. The breach notification shall apply to breaches of security that are discovered on or after the date that is thirty days after the date of publication of such interim final regulations.

**Business associate contracts required for certain entities**

Each organization, with respect to a covered entity, that provides data transmission of protected health information to such entity (or its business associate) and that requires access on a routine basis to such protected health information, such as a Health Information Exchange Organization, Regional Health Information Organization, E-prescribing Gateway, or each vendor that contracts with a covered entity to allow that covered entity to offer a personal health record to patients as part of its eHR, is required to enter into a written contract with such entity and shall be treated as a business associate of the covered entity.

**Clarification of application of wrongful disclosure criminal penalties**

Section 1177(a) of the Social Security Act (42 U.S.C. 1320d-6(a)) is amended by adding a new sentence that confirms that a person shall be considered to have obtained or disclosed individually identifiable health information illegally if the information is maintained by a covered entity and the individual obtained or disclosed such information without authorization.

**Improved enforcement**

Instances of willful neglect now require the Secretary to impose penalties that appear in HIPAA, and the penalties for violations have been tiered and increased.

**Audits**

The Secretary may provide for periodic audits.

**Relationship to other laws**

Under Section 1178 of the Social Security Act, as amended by HIPAA, the security standards preempt any contrary provision of state law, with certain specified exceptions (*e.g.*, public health reporting). Pursuant to HIPAA Section 264, however, the privacy rule does not preempt a contrary provision of state law that is more protective of patient medical privacy. Psychotherapy notes (*i.e.*, notes recorded by a mental health professional during counseling) are afforded special protection under the privacy rule. Almost all uses and disclosures of such information require patient authorization.

The HITECH Act retains the preemption provisions in Section 1178 and preserve the HIPAA privacy and security standards to the extent that they are consistent with the HITECH Act. The Secretary is required by rulemaking to amend such standards as necessary to make them consistent with the HITECH Act.

**Effective date**

Except as otherwise specifically provided elsewhere, the HITECH provisions shall take effect on the date that is twelve months after the date of the enactment of the HITECH Act. In other words, February 17, 2010.

**Studies, reports, guidance**

For the first year beginning after the date of the enactment of the HITECH Act and annually thereafter, the Secretary shall prepare a report concerning complaints of alleged violations of law relating to privacy and security of health information. Each report shall be made available to the public.

Not later than February 17, 2010, the Secretary, in consultation with the FTC, shall conduct a study, and submit a report on privacy and security requirements for entities that are not covered entities or business

associates. Not later than twelve months after the date of the enactment of the HITECH Act, the Secretary shall, in consultation with stakeholders, issue guidance on how best to implement the requirements for the de-identification of protected health information

Not later than one year after the date of the enactment of the HITECH Act, the Comptroller General of the United States shall submit a report on the best practices related to the disclosure among health care providers of protected health information of an individual for purposes of treatment of such individual. Not later than five years after the date of enactment of the HITECH Act, the Government Accountability Office shall submit to Congress and the Secretary of Health and Human Services a report on the impact of any of the provisions of this Act on health insurance premiums, overall health care costs, adoption of electronic health records by providers, and reduction in medical errors and other quality improvements. The Secretary shall study the definition of "psychotherapy notes" with regard to including test data that is related to direct responses, scores, items, forms, protocols, manuals, or other materials that are part of a mental health evaluation, as determined by the mental health professional providing treatment or evaluation in such definitions and may, based on such study, issue regulations to revise such definition.

## **DOLLARS AVAILABLE FOR PRIVATE SECTOR IN FEDERAL STIMULUS BUT BE MINDFUL OF IMPORTANT DETAILS**

### **SECTION 4. TRANSPARENCY AND LABOR AND MATERIALS REQUIREMENTS**

The Act provides a framework for the oversight of the use of funds appropriated under the Act (so-called "covered funds") to ensure that the process of obtaining and using covered funds on the one hand, and issuing and managing covered funds on the other, will be transparent from start to finish and will comply with the applicable parts of the Act and other laws.

#### **Reporting Responsibilities**

The Act imposes significant certification and reporting obligations on state governments and other entities that receive covered funds directly from a federal agency. These entities are referred to as "recipients" under the Act. If a state intends to use covered funds, its governor must certify that the state will request and use the covered funds and that those funds will be used to create jobs and promote economic growth. Further, the governor of any state that uses covered funds for infrastructure investments must post to [www.recovery.gov](http://www.recovery.gov) a certification that includes specific details of the infrastructure project. The governor must also certify that he or she accepts responsibility that the infrastructure investment is an appropriate use of taxpayer dollars.

Recipients of covered funds also have reporting duties. Under Section 1512 of the Act (the Jobs Accountability Act), recipients must submit quarterly reports to the federal agency that issued the covered funds. The report must list in detail all projects or activities that use covered funds. For infrastructure investments made by state and local governments, the report must include the purpose, total cost, and rationale for funding the infrastructure investment and the name of the person to contact to discuss concerns with the infrastructure investment. If applicable, the report must also contain specific information about subcontracts or subgrants awarded by the recipient. Further, recipients that report subcontracts or subgrants must register with the Central Contractor Registration database or complete other registration requirements as determined by the Director of the Office of Management and Budget.

The reports required by the Jobs Accountability Act apply to all recipients. But reports are also required elsewhere under the Act. For example, under Title XIV of the Act, which provides for Department of Education funding, a state receiving covered funds must provide to the Secretary of Education the same reporting information required under the Jobs Accountability Act. A report under Title XIV, however, must contain additional information, including a description of the state's progress in reducing inequities in the distribution of highly qualified teachers.

The Act expects that its certification and reporting requirements will cause confusion, particularly among recipients. To address these concerns, the Act requires that the federal agencies expending covered funds provide user-friendly means for recipients of funds to meet those requirements. The Act does not indicate, however, how that information will be provided to recipients.

The frequent publication of comprehensive reports will allow the federal government to trace the covered funds to end-users. End-users should be aware that their use of covered funds is subject to the Act and understand the implications of violating the Act's provisions. As a corollary, it appears that the recipients who subcontract and make subgrants remain liable for the actions of their subcontractees or subgrantees.

These recipients will not be able to "contract away" their obligations under the Act. The accountability of recipients is even more apparent when assessing the far-reaching investigative and auditing authority of the inspectors general and other federal entities created for the purpose of tracking the use of covered funds as outlined below.

### **Accountability**

The Act contains many important auditing and investigation provisions designed to prevent waste, fraud and abuse. The Act includes some unique restrictions on the use of covered funds, such as the "Buy American," prevailing wage standard and "shovel ready" requirements that are discussed below. Compliance with these provisions will certainly be included in the rubric of heightened scrutiny and transparency created by the Act.

#### **Inspectors General**

The inspectors general, in particular, are directed to take a lead investigatory role. The Act grants specific appropriations to the inspectors general, ensuring their financial independence and that funding will be used by the inspectors general to conduct audits and investigations of projects and activities carried out with covered funds.

The Act grants considerable investigative authority to the inspectors general to complete those audits and reviews. With respect to each contract or grant involving covered funds, any representative of the appropriate inspector general is authorized (a) to examine the records of the contractor or grantee, any of its subcontractors or subgrantees, or any state or local agency administering a contract that pertains to or involves transactions relating to, the contract, subcontract, grant, or subgrant; and (b) to interview any officer or employee of the contractor, grantee, subgrantee, or agency regarding those transactions.

The Act also requires inspectors general to review concerns raised by the public relating to investment of the funds. Generally, those review findings must be relayed to the head of the appropriate federal department or agency. In addition, the findings of such reviews and the results of any related audits must be posted on the inspector general's website and linked to [www.recovery.gov](http://www.recovery.gov).

#### **The Recovery Accountability and Transparency Board**

The Act creates an additional layer of oversight by establishing a Recovery Accountability and Transparency Board (the "Board"), which is made up of the inspectors general from the various federal agencies and a chairperson designated or appointed by the President. The Board's purpose is to prevent fraud, waste, and abuse of the use of covered funds. Among other responsibilities, the Board is required to review recipient reports, review whether competition requirements applicable to contracts and grants using covered funds have been satisfied, audit covered funds to determine whether there is wasteful spending, poor contract or grant management, or other abuses are occurring. The Board must also refer matters it considers appropriate for investigation to the inspector general for the agency that disbursed the funds.

#### **Board Interaction with Inspectors General**

The Board's audit and review authority is similar to the audit and review authority of the inspectors general. The Board's audits and reviews may be independent of the auditing efforts of the relevant inspector general. To avoid duplication, however, the Act encourages the Board to

coordinate its audits and reviews with the inspectors general. Whether or not it coordinates with the inspector general, the Board has broad authority in conducting its audits and reviews, including the right to issue subpoenas to compel the testimony of persons who are not federal officers or employees.

Despite the Board's concurrent oversight powers, the Act preserves the independent auditing authority of the inspectors general. The Board may ask an inspector general to conduct or refrain from conducting an audit or investigation. If the inspector general rejects that request, the inspector general must submit a report to the Board, the head of the applicable agency, and the congressional committees of jurisdiction, including the Committees on Appropriations of the Senate and House of Representatives. The report must contain the reasons that the inspector general has rejected the request. The inspector general's decision, as stated in the report, is final.

### **Board Recommendations and Hearings**

The Board is required to recommend to federal agencies measures to prevent fraud, waste and abuse relating to covered funds. An agency that receives a recommendation from the Board must report to the President, the congressional committees of jurisdiction, including the Committees on Appropriations of the Senate and House of Representatives, and the Board on (a) whether the agency agrees or disagrees with the recommendations; and (b) any actions the agency will take to implement the recommendations.

The Board must also submit reports to the President and Congress, including the Committees on Appropriations of the Senate and House of Representatives. The Board will provide (a) "flash reports" on potential management and funding problems that require immediate attention; (b) quarterly reports summarizing the findings of the Board and the findings of inspectors general; and (c) annual reports that consolidate the quarterly reports. The Board will also submit to Congress other reports that the Board considers appropriate. All reports submitted by the Board shall be made publicly available and posted on [recovery.gov](http://recovery.gov).

The Board is authorized to hold public hearings, conduct necessary inquiries and demand certain information and assistance. At the Board's request, the head of the applicable agency is required to (a) make all officers and employees of that agency available to provide testimony to the Board and Board personnel and (b) furnish requested information or assistance to the Board, or an authorized Board designee. If information is unreasonably refused or not provided, the Board is required to immediately report the circumstances to the congressional committees of jurisdiction, including the Committees on Appropriations of the Senate and House of Representatives.

### **Board Website**

The Board is required to maintain [www.recovery.gov](http://www.recovery.gov), a user-friendly website intended to foster accountability and transparency in the use of covered funds. The Act indicates that [www.recovery.gov](http://www.recovery.gov) will provide essential information relating to the Act, such as audit findings, grant and contract information, data on contracts awarded, means for public feedback, and a plan from each federal agency for using funds, among other information.

### **Recovery Independent Advisory Panel**

By establishing the Recovery Independent Advisory Panel, the Act creates a third layer of bureaucracy to monitor covered funds. The panel is composed of five members appointed by the

President. The President is directed to appoint members to the Panel on the basis of expertise in economics, public finance, contracting, accounting, or any other relevant field. The Panel is required to make recommendations to the Board on actions the Board could take to prevent fraud, waste, and abuse relating to covered funds.

## **General Provisions**

### **Preference for Shovel-ready Projects and Description of Prohibited Projects**

Recipients using covered funds for infrastructure investments are required to give preference to activities that can be started and completed expeditiously. Recipients are directed to set a goal of using at least 50 percent of the funds for activities that can be initiated before June 17, 2009. Recipients must also use covered funds in a manner that maximizes job creation and economic benefit. None of the covered funds may be used by any state or local government, or any private entity, for casinos or other gambling establishments, aquariums, zoos, golf courses, or swimming pools.

### **Buy American**

Under the Act, all of the iron, steel, and manufactured goods used in public building or public work projects must be produced in the United States. That rule does not apply if the applicable head of the federal department or agency finds that (a) applying the rule would be inconsistent with the public interest; (b) iron, steel, and the relevant manufactured goods are not produced in the United States in sufficient and reasonably available quantities and of a satisfactory quality; or (c) inclusion of iron, steel, and manufactured goods produced in the United States will increase the cost of the overall project by more than 25 percent. If the head of a federal department or agency determines that it is necessary to waive the "Buy American" rule based on an exception listed above, the head of that department or agency is required to publish in the Federal Register a detailed justification of the waiver.

### **Prevailing Wage**

Contractors and subcontractors on projects funded directly by, or assisted in whole or in part by, the Federal Government under the Act must pay their laborers and mechanics wages at rates not less than those prevailing on projects of a character similar in the locality as determined by the Secretary of Labor.

### **Environmental reviews**

Under the National Environmental Policy Act ("NEPA"), a federal law since 1969, all federal agencies must assess the possible adverse environmental impact resulting from any "major action" undertaken by such agency. NEPA is the act pursuant to which, federal agencies must sometimes issue environmental impact statements as conditions to significant public works and other projects.

Project developers may regard the NEPA process, especially where an environmental impact statement is involved, as a bureaucratic interference that increases costs and causes delays. The drafters of the Act were certainly cognizant of NEPA's potential impact on the use of covered funds. The Act includes certain Congressional findings that appear to reaffirm the commitment to NEPA. At the same time, the Act directs agencies to find the most expeditious means of complying with NEPA. This is yet another mysterious mandate that requires further agency interpretation.