

IRS GUIDANCE IN THE 2008 DOWNTURN

INTRODUCTION

With U.S. corporate bankruptcies poised to hit a decade-long high as a result of the economic impact of COVID-19, we have prepared these materials that detail the key bankruptcy tax issues and guidance offered by Linda Swartz, the chair of Cadwalader's Tax Group, in old and new speeches and panels. We hope you find this presentation to be both useful and informative.

For additional information, contact [Linda Swartz](mailto:linda.swartz@cwt.com) (linda.swartz@cwt.com).

Upcoming speaking engagements:

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| October 14, 2020 | <ul style="list-style-type: none">• Linda Swartz will be presenting "Tax Strategies for Financially Troubled Businesses and Other Loss Companies" at PLI's Tax Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations & Restructurings 2020 |
| November 5, 2020 | <ul style="list-style-type: none">• Linda Swartz will be presenting "A Cause for Distress? The Ways the Federal Income Tax Pushes Taxpayers into Bankruptcy" at The University of Chicago Tax Conference |
| January 25, 2021 | <ul style="list-style-type: none">• Linda Swartz will be presenting "Distressed Corporations: Creditor and Shareholder Issues" at the 2021 University of Southern California Federal Tax Institute |
| February 8, 2021 | <ul style="list-style-type: none">• Linda Swartz will be presenting "Workouts and Debt Restructurings" at PLI's 23rd Annual Real Estate Tax Forum |
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LINDA Z. SWARTZ



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Linda Swartz, the longtime chair of Cadwalader's Tax Group and member of the Firm's Management Committee, focuses her practice on structuring complex restructurings, bankruptcies, mergers and acquisitions, spin-offs, joint ventures, and foreign tax planning strategies. She also regularly advises clients on fund structures, financings and derivative transactions.

Linda is consistently recognized as one of the leading tax lawyers in the country. She was recently named one of 14 "Influential Women In Tax Law" by *Law360*, noted for her role as "a key architect on billion-dollar transactions involving major multinational companies" with clients describing her tax structuring expertise as "so strong that we don't even go to the IRS to get a blessing from them. We go to Linda to get a blessing from her." She has been described by *Chambers USA* as "acclaimed for her vast reservoir of practical knowledge of the U.S. tax code" and "an expert on the law of today but cognizant of where the law might go in the future, allowing clients to make decisions which last for the next ten years." Clients quoted by *The Best Lawyers* in America have described Linda as "the foremost U.S. tax advisor on structured acquisition and divestiture deals" and "a professional force of nature" with "extraordinary technical ability, coupled with fiercest and most trenchant deal negotiation skills of any transactional tax lawyer." She was also recognized as "2017 Foreign Tax Planning Lawyer of the Year" by *Finance Monthly*, and *Dow Jones*, reporting on Procter & Gamble's Reverse Morris Trust transaction with Coty, noted that "it isn't often you see a tax adviser credited on a deal, but that's exactly what happened for Cadwalader, Wickersham & Taft in P&G's complicated \$12.5 billion unloading of its beauty business to Coty."

Linda is widely regarded as a thought leader in the industry and is a prolific speaker and writer on a wide range of transactional tax issues, with articles that include "Partnership Bankruptcy Tax issues," "Debt Exchanges," "Bankruptcy Tax Issues," and "Bankruptcy Tax 101." She also authors the chapters on Debt Exchanges in *Collier on Bankruptcy Taxation* (Matthew Bender) and Securities Lending Transactions in *Taxation of Financial Institutions* (Clark Boardman Callaghan). In addition to writing, she speaks on a broad range of topics, including each year on workout and bankruptcy tax issues at the corporate and real estate tax PLI conferences.

Linda is a member of the Executive Committee of the New York State Bar Association Tax Section and has chaired its Tax-Free Reorganizations; Corporations; Bankruptcy; Consolidated Returns; Real Property; and Tax Accounting and Basis Committees.

Linda received her J.D. from University of Pennsylvania Law School, and her B.A. from Bucknell University, where she graduated *magna cum laude* and was elected to Phi Beta Kappa.

FREDDIE & FANNIE HELP, NO HYDOS, AND SECURITIES LOAN TERMINATIONS

- The takeovers of Fannie Mae and Freddie Mac were not treated as section 382 ownership changes. Notices 2008-76 and 2008-84.
- Relying on Internal Revenue Code section “zero,” IRS excepted from the AHYDO rules certain debt issued pursuant to a prior financing commitment through 2010.
- Securities loans terminated because of a borrower’s bankruptcy filing did not trigger gain or loss if the lender promptly applied the collateral to the purchase of identical securities. Rev. Proc. 2008-63.
 - Gain or loss may be avoided on the exchange of certain identical securities.
See I.R.C. § 1058.
- Promise of regulations to relax elements of the anti-stuffing rules under IRC section 382(l)(1). Notice 2008-78.

ELIMINATING 382 LIMITATION ON BANKS' BUILT-IN LOSSES (NOTICE 2008-83)

- Controversial Notice 2008-83 held that deductions properly allowed to a bank after an ownership change with respect to bad debt or loan losses, including deductions for a reasonable addition to a bad debt reserve, would not constitute built-in deductions on the ownership change date. Accordingly, those losses would not be limited if the bank had a net unrealized built-in loss (a NUBIL) on an ownership change date.
 - After an ownership change, a loss company's section 382 limitation generally applies to any deductions claimed with respect to the loss corporation's NUBIL during the first five years after the change date, assuming *de minimis* tests are satisfied. See I.R.C. § 382(h).
- The American Recovery and Reinvestment Act of 2009 (the 2009 Act) revoked Notice 2008-83, effective January 16, 2009.

SECTION 382 CONSEQUENCES OF TREASURY ACQUISITIONS PURSUANT TO THE 2008 ACT

Notice 2009-14 provides guidance with respect to the following programs (collectively, the Programs):

Capital Purchase Program for publicly traded issuers (Public CPP)

Capital Purchase Program for private issuers (Private CPP)

Capital Purchase Program for S corporations (S Corp CPP)

Targeted Investment Program (TARP TIP)

Automotive Industry Financing Program (TARP Auto)

Section 101(c)(5) of EESA (the 2008 Act) authorizes the Treasury Secretary to issue **“such regulations and other guidance as may be necessary or appropriate to carry out the purposes of the Act.”**

Section 382(m) provides that **“the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of sections 382 and 383.”**

NOTICE 2009-14

Stock

Treasury's stock ownership for section 382 purposes will not increase by reason of stock it acquires pursuant to the Programs, but any otherwise qualifying stock it holds will be considered outstanding for purposes of determining the stock ownership of other 5% shareholders on a testing date.

- Any shares acquired and held by Treasury pursuant to the Programs will be treated on all testing dates after the shares are redeemed as though they had never been outstanding.
- Any shares Treasury acquired pursuant to the Programs and then transferred will be treated as section 1504(a)(4) stock that will be disregarded for section 382 purposes while subsequently held by any other party.

Warrants

Warrants acquired by Treasury pursuant to the 2008 Tax Act are treated as:

- Options, and not stock, for all purposes while held by any party that receives the warrants pursuant to the Public CPP, TARP TIP, or TARP Auto.
- Section 1504(a)(4) stock that is disregarded if acquired pursuant to the Private CPP.
- An ownership interest in the underlying debt if acquired pursuant to the S Corp CPP.

Options

Options that Treasury acquires pursuant to the Programs will not be deemed exercised under section 1.382-4(d)(2) while held by Treasury.

- Overrides Treasury Regulation section 1.382-4(d)(9), which generally treats options as exercised if a principal purpose of such option is to avoid application of section 382 and an ownership, control, or income test is satisfied.

The section 382(l)(1) anti-stuffing rules will not apply to any Treasury capital contributions made pursuant to any of the Programs.

NOTICE 2010-2

General Rule

No instrument issued to Treasury other than pursuant to TARP CAP shall be treated as stock for section 382 purposes while held by Treasury or other holders.

- Instruments denominated as preferred stock will be treated as section 1504(a)(4) stock for section 382(e)(1) purposes.

Instruments issued to Treasury pursuant to TARP CAP will be classified under general tax principles.

Notice 2010-2 states: “In exercising its authority under [the 2008 Act] in this Notice, Treasury and the Service intend no implication regarding the Federal income tax results that would obtain with respect to instruments that are not specifically described in this notice.”

Operational Rules

- Warrants issued to Treasury pursuant to the Programs, except Private CPP and S Corp CPP, will generally be treated as options, not stock, including after transfers to subsequent holders. The warrants will not be treated as exercised while held by Treasury for purposes of section 382.
- For all purposes, any amount received by an issuer in exchange for instruments issued to Treasury under a TARP-related program shall be treated as received solely for such instruments.
- The applicable sections of Notice 2010-2 also apply to instruments received by Treasury in exchange for instruments issued to Treasury under a TARP-related program.

Stock Ownership Rules

Stock held by Treasury shall not be treated as increasing Treasury’s percentage ownership of stock for purposes of section 382, although the stock is considered outstanding while held by Treasury for purposes of determining the stock ownership of 5% shareholders on any testing date.

- Once stock owned by Treasury is redeemed, it is treated as though it had never been outstanding.
- Treasury intentionally did not extend this treatment to two-step transactions, e.g., a redemption of stock from Treasury followed by a sale of the stock to the public.
- If a sale of stock by Treasury creates a new public group, the group’s ownership of stock will not increase by reason of the Treasury sale, although it will increase (or decrease) as a result of all other transactions.