

SECTION 108(i)

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 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.

SECTION 108(i)

Elective COD Deferral

The 2009 Tax Act permits a corporation or other taxpayer that issued debt in connection with an active trade or business to irrevocably elect to defer COD arising from its “reacquisition” of the debt instrument in 2009 or 2010.

- A reacquisition includes: (i) an acquisition of debt for cash or other property, (ii) a deemed or actual debt for debt exchange, (iii) an exchange of debt for common (but not preferred) stock or a partnership interest, (iv) a contribution of debt to the capital of an issuer, and (v) complete forgiveness of the debt.
- Revenue Procedure 2009-37 automatically extends the due date for making a section 108(i) deferral election for 12 months.
- Issue as to whether foreclosures constitute reacquisitions.

Election Mechanics

Separate deferral elections may be made for each debt instrument, including instruments that are part of the same issue.

- Taxpayer electing deferral must forego other COD exclusions, e.g., bankruptcy or insolvency.
- Revenue Procedure 2009-37 authorizes partial elections to defer any portion of COD income realized with respect to a reacquisition.
- If two or more instruments are reacquired, different portions of COD may be deferred on each instrument.
- Portion of COD not deferred can be excluded under section 108(a) if applicable exceptions apply, e.g., insolvency, bankruptcy.

Inclusion of Deferred COD

Deferred COD is included in taxpayer’s income ratably over five taxable years beginning in 2014.

Deferred COD generally accelerated if taxpayer:

- sells substantially all of its assets,
- liquidates,
- ceases to do business, or experiences “similar circumstances,” or
- is a partner or shareholder of a passthrough entity that sells/exchanges/redeems its interest in the debtor.

Open acceleration issues include whether it is triggered by tax-free section 368, 351, or 721 dispositions, technical partnership terminations, deconsolidations, or conversions to/from corporate / LLC / S corp status.

SECTION 108(i) (cont'd)

Partnership Rules

Revenue Procedure 2009-37 provides special allocation and adjustment rules for partnerships.

- Section 108(i) requires a passthrough entity (rather than partners or owners) to make a deferral election with respect to the entity's COD income realized.
- Partnerships may tailor each deferral election to meet the needs of individual partners, addressing practitioner concerns that passthrough entities would be conflicted by differing desires of partners.
- Elaborate, detailed instructions are provided for partnership and S corporation reporting, including tiered structures. Partnerships must make reasonable efforts to obtain outside basis information where needed.

Corresponding Deferrals

Earnings and profits of CFCs other than RICs and REITs are adjusted for deferred COD income in the year the income is realized, not the year deferred income is includible in gross income. Rev. Proc. 2009-37.

- General rule under section 312(e): COD increases E&P currently unless it is excluded from gross income under section 108(a) *and* applied to reduce asset basis under section 1017.

Any decrease in a partner's share of liabilities under section 752 as result of deferred COD is also deferred to the extent it would cause income recognition under section 731 and is taken into account by the partner at same time, and to same extent, as the deferred COD.

Matching Deferred COD and OID

Any OID deductions accruing during the first five years on newly issued debt are deferred up to the amount of deferred COD and are deductible over the five year COD income recognition period.

- Note that a deferral election on debt acquired at a discount simply defers tax on COD, but a deferral election when a deemed or actual exchange of debt with the same principal amount that creates COD under the public trading rules may eliminate tax.
 - If the new debt has a remaining life of five to ten years, the present value of the constant yield deferred OID deductions (calculated on a constant yield basis) will exceed the present value of the deferred COD income (calculated on a straight line basis) on the exchanged debt if AHYDO relief applies. If the AHYDO rules limit the OID deductions, a net tax liability may result.

SECTION 108(i) (cont'd)

Partial Elections & OID Deductions

When a partial election is made in connection with COD realized on more than one debt instrument in an issue, the amount of OID required to be deferred may depend on whether taxpayers make different elections for each instrument in an issue, even if the same amount of aggregate COD is deferred.

- Electing to defer a portion of COD realized on each instrument will generally cause more OID deductions to be deferred. COD realized on only one instrument (or a limited number of instruments) in an issue will generally reduce the aggregate amount of deferred OID deductions, maximizing the amount of OID deductions allowed.
- Guidance needed regarding the application of the OID deferral rule to related party debt acquisitions.

Protective Deferral Elections

Revenue Procedure 2009-37 authorizes protective elections to defer additional COD income if the IRS concludes on audit that COD income on a taxpayer's return was understated.

- Partial protective elections are permitted.
- Protective elections may be made even if taxpayer's return shows no COD income.
- Such an election extends the statute of limitations and requires an election form to be attached to tax returns for the subsequent eight to nine years.