

IRS AS SECTION 382 RULEMAKER

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:

-
- | | |
|-------------------------|---|
| 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 |
-

LINDA Z. SWARTZ



Linda Z. Swartz
Chair, Tax
New York
(212) 504 6062
linda.swartz@cwt.com

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.

PLR 200605003

Taxpayer-friendly ruling that did not aggregate three related investment funds as a single “entity” for purposes of section 382, even though the three funds invested in parallel “in virtually every case.” If aggregated, the funds would have been a 5% shareholder and the purchase would have been prohibited under trading restrictions.

- Owners of stock of a loss corporation will be treated as an “entity” if the owners “have a formal or informal understanding among themselves to make a coordinated acquisition of stock.” Treas. Reg. § 1.382-3(a)(1).
- “A principal element in determining if such an understanding exists is whether the investment decision of each member of a group is based upon the investment decision of one or more other members.”
- The funds each represented that they did not acquire, or indicate to their investors that they would acquire, equity interests in the loss corporation (or any other issuer) for the purpose of accumulating ownership of any particular minimum percentage of an issuer’s equity interests, or changing or influencing control of the issuer.
- The IRS ruled that the funds did not have a “formal or informal understanding . . . to make a coordinated acquisition of stock” based solely on the information provided, and would not be treated as a single entity for the purposes of section 382 even though they consistently invested in parallel. Thus, no fund would be treated as a 5% shareholder as long as each single fund owned less than 5% of the loss corporation.

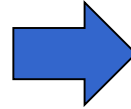
PLR 200713015

Scenario

Loss corporation (Loss Co) files for bankruptcy and files motion to impose trading restrictions on equity transfers to protect against section 382 ownership change

Entity A

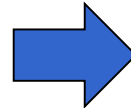
Acquires shares of Loss Co stock on the open market before court enters order imposing trading restrictions, becoming a 5% shareholder, and thereby triggering a section 382 ownership change.



At the request of Loss Co and Entity A, the Court orders that Entity A's purchase of Loss Co's stock be treated as "void *ab initio*," that its purchased shares be sold, and any profits above and beyond Entity A's costs be donated to charity.

Entities B & C

- Entities B and C are investment advisors that hold Loss Co common stock for their clients/advisees through a common custodian. B and C had no right to receive dividends or sales proceeds from the stock, but could buy, sell and vote the stock.
- B and C each filed an SEC Schedule 13G reporting ownership of more than 5% of Loss Co stock.



- No client or advisee of B or C filed a Schedule 13G reporting that it owned more than 5% of Loss Co stock.
- Loss Co had no actual knowledge that any of B's or C's clients/advisees owned more than 5% of its stock, or should be treated as members of a coordinated group.