



AMERICAN
BANKRUPTCY
INSTITUTE

2017 Annual Spring Meeting

Tax Implications of § 363 Sales

Hosted by the Legislation and Bankruptcy
Taxation Committees

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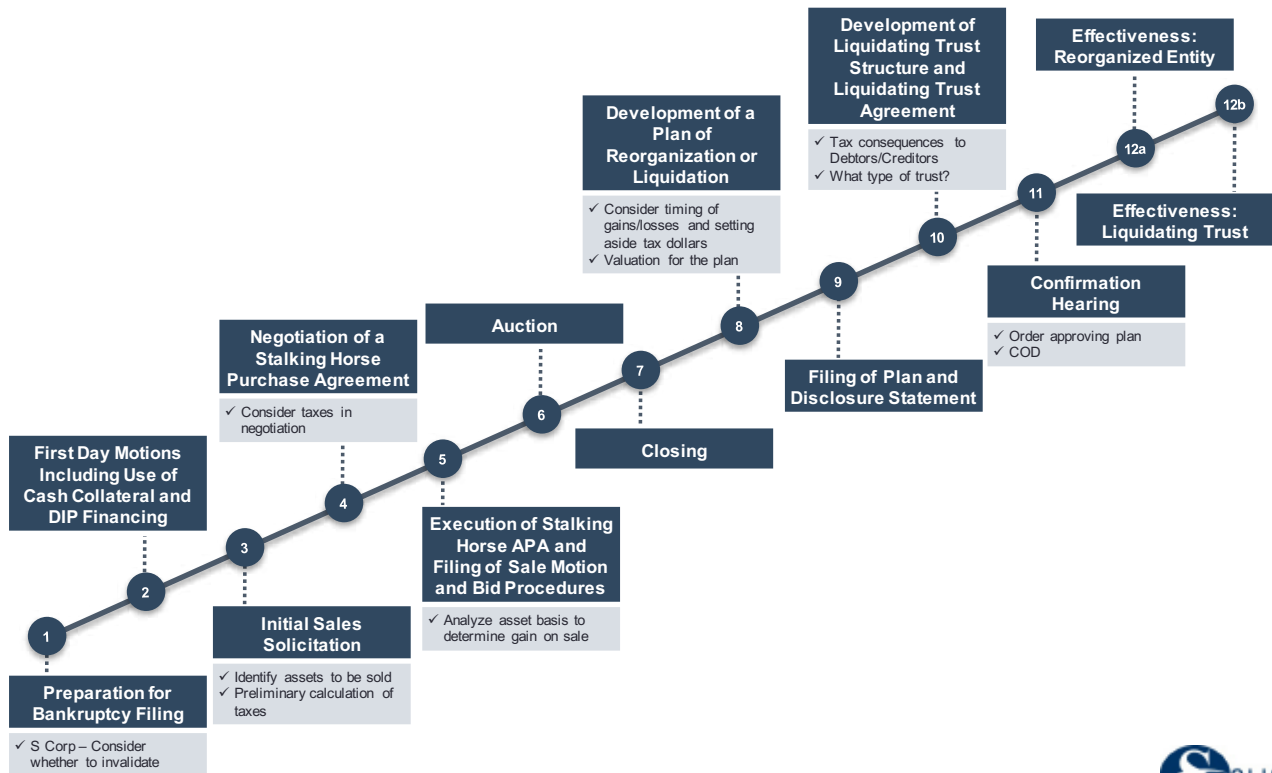
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Bankruptcy Timeline



Privileged and confidential



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Tax Implications of 363 Sales

Marriott Marquis, Washington, DC

April 21, 2017 – Draft Slides as of 2/7/17

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Overview

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- Cancellation of Debt Income
- IRC §382
- Section 363 Sales
 - Taxable
 - Tax-free (deferred) G Reorganization

Cancellation of Debt Income

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COD Income

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- “Except as otherwise provided . . . gross income means all income from whatever source derived . . .”. IRC §61(a)
- A taxpayer must generally recognize income upon a “discharge of its indebtedness” (COD income). IRC §61(a)(12).
- Amount of COD income is generally:
 - The excess of the principal amount (or adjusted issue price) of the debt *over*
 - The fair market value of any consideration paid in exchange for the debt

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COD Income – Recognition Exceptions

- Two exceptions to recognition of COD income:
 - **Title 11 Bankruptcy** – IRC §108(a)(1)(A)
 - When there is a discharge of debt in bankruptcy pursuant to the bankruptcy plan of reorganization, the **entire amount** of such COD income is excluded from income
 - **Insolvency** – IRC §108(a)(1)(B)
 - If the discharge occurs in an out-of-court restructuring or not pursuant to a plan of reorganization in a Title 11 case, the COD income amount is excluded from income **only to the extent the debtor is insolvent**
- If more than one exclusion applies under IRC §108(a)(1), then bankruptcy exception has priority

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COD Income – Recognition Exceptions (cont.)

- **Bankruptcy Exception** - COD income excluded if occurs in a Title 11 case
 - Refers to a petition for bankruptcy filed under Title 11 of the United States Code, but *only if*:
 - The taxpayer is under the jurisdiction of the court in such case, and
 - The discharge of the debt is either
 - Granted by court order, or
 - Pursuant to a plan approved by the court
 - Debt does not have to be listed debt as long as discharged by court
 - Entire amount of COD income excluded
- **Insolvency Exception**
 - Determination of insolvency - insolvency of the debtor is determined **immediately prior** to the discharge and is measured by the amount of the debtor's liabilities over the fair market value of the debtor's assets. IRC §108(d)(3).

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COD Income – Attribute Reduction

- However, the cost of utilizing the benefits of either exception is the reduction of debtor's tax attributes to the extent of the excluded COD income, in the following order (under IRC §108(b)):
 1. Net operating losses (NOLs) and NOL carryovers, without regard to any limit in use by IRC §382 (annual limitation after a change of ownership)
 2. General business credits
 3. Minimum tax credits
 4. Capital loss and capital loss carryovers
 5. Tax basis in property
 6. Passive activity loss and credit carryovers
 7. Foreign tax credit carryovers

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COD Income – Attribute Reduction (cont.)

- But, taxpayers may **elect** under IRC §108(b)(5) to apply reduction first against depreciable property (to the extent of tax basis) under IRC §1017
- The following non-depreciable assets may be treated as depreciable property for purposes of this election (IRC §1017(b)(3)):
 - Any real property treated as inventory
 - Stock of a subsidiary that files a consolidated return with the debtor, but only to the extent the subsidiary reduces the tax basis of its depreciable property
 - Basis in partnership interests to extent of the partner's proportionate share of depreciable property in the partnership, but only to the extent the partnership reduces the tax basis in its depreciable property
- Election beneficial when anticipate pre-change NOLs available in post-change years will exceed depreciation deductions
- Election not beneficial if pre-change NOLs that survive attribute reduction are significantly limited under IRC § 382

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COD Income – Attribute Reduction (cont.)

- Reduction Amount
 - Attributes other than credits are reduced on a dollar-for-dollar basis by the amount of the COD income excluded
 - Credits are reduced at a rate of 33 1/3¢ for each dollar of excluded COD income
 - Consolidated groups reduce attributes on a consolidated basis, not on a separate company basis
- Timing
 - General rule - attributes are reduced **after** the determination of tax for the taxable year of the discharge. IRC §108(b)(4).
 - Reduction of tax basis in property occurs on the first day of the taxable year following the year of discharge. IRC §1017(a).
 - Basis in property may not be reduced below the debtor's aggregate liabilities measured immediately after the discharge. IRC §1017(b)(2).
 - This limitation does not apply if the debtor elects to reduce basis before other attributes under IRC §108(b)(5)

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COD Income – Attribute Reduction (cont.)

- “Black hole” COD income
 - Any excluded COD in excess of the debtor's attributes disappears (*i.e.*, it does not reduce future attributes and is permanently excluded from income)
 - There may, however, be collateral consequences in a consolidated group
 - Note importance of the IRC §1017(b)(2) cap on asset basis reduction – this cap may leave taxpayer with significant asset basis notwithstanding black hole COD
- Strategies (Timing)
 - Review the tax attributes to be adjusted and the kind of assets in the bankruptcy
 - Discharge occurs upon court order (see IRS Advice Analyzes Timing of COD Income; TAM 2013-21-019)
 - Basis reduction applies to the basis of the property held on the first day of the taxable year following exclusion of COD from income (Reg §1.1017-1)

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COD Income – Attribute Reduction (cont.)

- Carefully consider what assets will be sold/retained in a 363 sale
 - Which assets will produce the least taxable gain? (BUT – Don't let the tail wag the dog)
 - Which assets will be subject to attribute reduction
- Consider timing of confirmation hearing – early in the debtor's fiscal year generally more advantageous than later
- Be sure appropriate systems are in place to identify basis of retained assets on date of discharge

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IRC §382

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IRC §172

- Net operating losses (NOLs) arising in taxable years beginning after August 5, 1997 may be carried back 2 years and carried forward 20 years.
- NOLs generated prior to this date may be carried back 3 years and carried forward only 15 years.
- The rules in effect for the year a loss is sustained controls the treatment.
- There are modified carryback/carryforward rules for REIT's, specified liability losses, casualty and theft losses, certain federally declared disaster losses, and farming losses.

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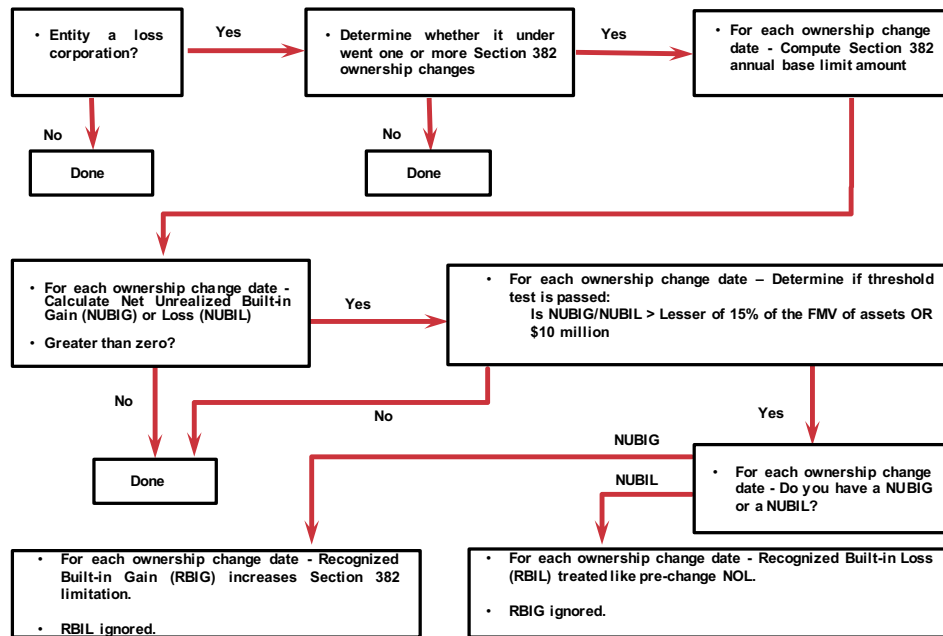
IRC §382 – Overview

IRC §382 limits a corporation's annual use of NOL carryforward after a more than 50% change in its 5% shareholders' stock ownership within a 3-year period.

- Most bankruptcy plans of reorganization produce ownership changes for IRC §382 purposes
- Annual limitation generally equals loss corporation's equity value immediately prior to ownership change multiplied by "long-term, tax-exempt rate" for the month of the ownership change.
 - February 2017 rate = 2.09% (Rev. Rul. 2017-4)
- NOLs are lost if corporation does not continue business enterprise for at least 2 years after ownership change.

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IRC §382 – Overview Flowchart



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IRC §382 – Limitation on Utilization of NOLs

- If an IRC §382 ownership change has occurred, a **Loss Corporation** may only use its **Pre-change Loss** to offset **Post-change Taxable Income** in an amount equal to the annual **IRC §382 Limitation**. Any unused IRC §382 Limitation in any post-change year is added to the IRC §382 Limitation for the next post-change year.
 - A **Pre-change Loss** means –
 - Net operating losses (NOLs) generated in the same taxable year as the IRC §382 ownership change and allocated to the period prior to the ownership change.
 - NOL Carryforwards
 - Certain Credit Carryforwards
 - RBIL recognized after the ownership change to the extent the corporation has a NUBIL on the change date.
 - **Post-Change Taxable Income** means any taxable income recognized after the ownership change date whether or not attributable to RBIG.

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IRC §382 – Loss Corporation

- A **loss corporation** is a corporation which --
 - is entitled to use a NOL, capital loss carryover, carryover of excess foreign tax credit, general business credit carryover under IRC §39 or minimum tax credit carryover under IRC §53;
 - for the taxable year that includes a testing date has any of the losses or unused credits listed above; or
 - has a NUBIL.

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IRC §382 – Determination Ownership Change

- Under very complex rules, a IRC §382 ownership change occurs when the **5% Shareholders** of a loss corporation have increased their percentage ownership as of a **testing date**, in the aggregate, by more than 50 percentage points during a **testing period**.
 - A **5% Shareholder** is either an individual that owns by value, at any time during the testing period, 5% or more of the loss corporation's stock, or a public group.
 - Special “look-through” rules generally apply to stock of a loss corporation owned by corporations or partnerships to determine individual indirect stock ownership.
 - Shareholder information is obtained from SEC filings (public companies) including Forms 10-K, 10-Q, and 13G, or equity capitalization tables (private companies).
 - Loss corporation stock owned by “Investment Advisors” (as indicated on Form 13G) requires special scrutiny to determine actual/beneficial ownership.
 - One or more public groups are created by applying complex IRC §382 aggregation and segregation rules.

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IRC §382 – Determination of Ownership Change (cont.)

- A **testing date** is generally any date upon which there is any change in the respective ownership of stock of a loss corporation that affects the percentage of stock owned by any person who is a 5% shareholder before or after the change.
 - Testing dates can also include dates upon which any of the following occurs: a reorganization (taxable or tax-free); a public offering; or a stock redemption.
- A **testing period** generally is the three year period ending on the testing date.
 - The testing period begins no earlier than:
 - the day following the last ownership change, and
 - the first day of either the first taxable year from which there is a loss carryover.

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IRC §382 – Annual Base Limit Calculation

The annual IRC §382 limitation is computed utilizing the following formula:

	Value of 100% of all stock (common and preferred) of the loss corporation
Less:	Adjustments to Fair Market Value <ul style="list-style-type: none"> • Substantial Non-Business Assets • Capital Contributions • Redemptions/Corporate Contractions • Controlled/Non-consolidated Subsidiaries
Equals:	Value of Loss Company for Section 382 Limitation Purposes
Multiplied by :	Applicable Long-term Federal Tax-Exempt Rate (2.09% for section 382 ownership changes during February 2017)
Equals:	Annual Section 382 Limitation

Note that the annual IRC §382 limitation is \$0 if the loss corporation does not continue the business that it was in prior to the change date at all times during the 2-year period beginning on the change date.

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IRC §382 – Annual Base Limit Calculation – Adjustments to Fair Market Value

The following questions should be asked to determine whether value of loss corporation needs to be adjusted:

- **Substantial Non-Business Assets** – (See IRC §382(l)(4))
 - Does the 1/3 (or more) of the value of the total assets of the loss corporation immediately after a section 382 ownership change consist of investment assets (including generally cash, stock, marketable securities, and similar investment assets)?
- **Capital Contributions** -- (See IRC §382(l)(1) and Notice 2008-78)
 - Have any capital contributions been received by the loss corporation at any time during the 2-year period ending on the section 382 ownership change date?

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IRC §382 – Annual Base Limit Calculation – Adjustments to Fair Market Value (cont.)

- **Redemptions/Corporate Contractions** -- (See IRC §382(e)(2))
 - Have any redemptions of stock or other corporation contractions of the loss corporation occurred in connection with the IRC §382 ownership change?
- **Controlled/Non-consolidated Subsidiaries** -- (See Treas. Reg. §1.382-8)
 - Does the loss corporation own (directly or through attribution) at least 50 percent of the total voting power of all classes of voting stock and 50 percent of the total value of all classes of stock, but less than 80 percent of the total voting power of all classes of voting stock and 80 percent of the total value of all classes of stock, of one or more U.S. or foreign corporations?

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IRC §382 – Successive Ownership Change Rules

- The successive ownership change rules apply if more than one IRC §382 ownership change has occurred for a loss corporation and can impact the amount of utilizable NOLs.

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IRC §382 – Computation of Net Unrealized Built-in Gain and Loss under IRC §382(h)

NUBIG and NUBIL is generally computed using the following formula:

	Aggregate Fair Market Value of All Assets of Loss Corporation Immediately Before Ownership Change Date
Less:	Aggregate Basis of Loss Corporation in its Assets Immediately Before Ownership Change Date
Plus:	Built-in Income Items
Less:	Built-in Deduction Items
Plus:	Positive section 481 Adjustments
Less:	Negative section 481 Adjustments
<hr/>	
Equals:	NUBIG/(NUBIL) Amount

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IRC §382 – Threshold Requirement – NUBIG and NUBIL

- If the calculated NUBIG/NUBIL amount is greater than \$0, it must exceed the lesser of:
 - 15% of the fair market value of the loss corporation's assets immediately before the section 382 ownership change (not taking cash, marketable securities, and other similar items into account), or
 - \$10,000,000,

otherwise, the NUBIG/NUBIL amount is \$0.

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IRC §382 – Recognized Built-in Gain and Loss

- **RBIG/RBIL:**
 - Requires a recognition event during the 60 month period following the ownership change date.
 - Is limited by both:
 - The NUBIG/NUBIL amount, and
 - The built-in gain/built-in loss amount in the asset at the time of the ownership change.
 - The IRC §382 limitation is increased for RBIG only to the extent of the loss corporation's NUBIG.
 - RBIL are subject to the IRC §382 limitation to the extent of the loss corporation's NUBIL.
 - RBIL includes any amount allowable as depreciation, amortization or depletion except to the extent the taxpayer establishes that such deduction is not attributable to a built-in loss.
 - Notice 2003-65 provides safe harbors on the computation of NUBIG/NUBIL/RBIG/RBIL.

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IRC §382 – Rights Plans

– Purpose

- Designed to attempt to protect a corporation's NOLs by prevent a IRC §382 ownership change.
- Accomplish goal by detering acquisition of greater than [4.99%] of corporation's common stock without consent of the corporation's Board.

– IRC §382 rights plans will not:

- Protect against sales by existing historical 5% shareholders;
- Prevent acquisitions to intentionally trigger the plan; or
- Absolutely protect against stock acquisitions that would impair or destroy the value of the NOLs.

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IRC §382 – Rights Plans (cont.)

– How they work:

- Board adopts rights plan by declaring a dividend of a right to acquire [1/1000th] of a share of a new series of preferred stock for each share of common stock.
- Rights attach to, and trade with, common stock.
- Upon a distribution date (e.g., [10] days after a person acquired [4.99%] or more of the common stock or commences a tender offer to acquire [4.99%] or more of the common stock), rights detach and trade separately.
- Rights represent the right to acquire the new preferred shares in exchange for payment of the exercise price until the "triggering event" (*i.e.*, the acquisition of shares beyond the applicable threshold).
- Upon the triggering event,
 - all rights held by the triggering stockholder become void; and
 - all other rights can be exercised and new shares can be purchased with a value of twice the common share value (diluting the triggering stockholder).
- Board may exempt acquisitions before or after a triggering event, provided it determinates the acquisition has not or will not jeopardize the NOLs.

- Representative companies that have adopted IRC §382 Rights Plans include Beazer Homes, Ambac, Windstream, Broadwind Energy and Enzon.

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IRC §382 – Special Rules Upon Emergence From Bankruptcy

IRC §382 provides two special rules for an ownership change effected pursuant to a bankruptcy plan or reorganization.

- **IRC §382(l)(5)** – The IRC §382 limitation does not apply if the shareholders and creditors of the loss corporation immediately before the ownership change also own at least 50% of the loss corporation after the ownership change
 - A loss corporation may elect out of IRC §382(l)(5)
- **IRC §382(l)(6)** – Permits the loss corporation to calculate its IRC §382 limitation based on its value immediately after the ownership change

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Section 363 Sales

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363 Sales – Overview

- 11 U.S.C. §363(b) – Chapter 11 debtor may sell assets with approval of bankruptcy court after notice and a hearing
- When debtor sells all or substantially all of the assets, the transaction may be structured as either a
 - Taxable sale of assets, or
 - Tax-free (deferred) G reorganization
- Parties must document such agreement in their asset purchase agreement

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363 Sales – Taxable sale of assets

- Lump-sum purchase price must be allocated to specific assets
- Purchaser takes cost basis in each asset
- Debtor recognizes gain/loss on an asset-by-asset basis on the difference between the fair market value of the consideration received and debtor's tax basis in each asset
 - On gain recognition
 - debtor may offset gains with existing tax attributes (e.g. NOL carryforwards or credits)
 - But tax attributes do NOT transfer to purchaser
 - Debtor may have tax liability

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363 Sales – Tax free/deferred (G reorg)

- Overview
 - Debtor generally has no tax liability on exchange of its assets for purchaser's qualifying stock and securities
 - Purchaser's tax basis in each asset equals debtor's
 - Purchaser succeeds to all debtor's tax attributes (e.g. NOLs and credits)

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363 Sales – G reorg (cont.)

- IRC §368(a)(1) defines certain corporate transactions treated as “tax free”
- A reorganization under IRC §368(a)(1)(G) (a “**G Reorganization**”) means:
 - a transfer by a corporation of all or part of its assets to another corporation **in a title 11 or similar case**; but generally only if –
 - Purchaser is a corporation for U.S. federal tax purposes
 - Debtor corporation transfers all or substantially all its assets to purchaser
 - Purchaser pays debtor with purchaser's stock or securities
 - Debtor distributes to its stockholders and security holders the stock and securities it receives in timely liquidation pursuant to an adopted plan
- Reorganizations must meet requirements to qualify under IRC §368(a)(1)
 - Statutory requirements
 - Regulatory requirements

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363 Sales – G reorg (cont.)

- Statutory Requirements
 - Title 11 or similar case
 - Debtor must liquidate
 - Distribution an receipt of acquiring company's stock or securities under IRC §354
 - Substantially all test under IRC §354
 - Plan of reorganization
- Regulatory Requirements
 - Continuity of shareholder interest test
 - Continuity of business enterprise test
 - Business purpose test
 - Proposed net value test

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363 Sales – G reorg (cont.)

- Title 11 or similar case – IRC §368(a)(3)
 - A case under the Bankruptcy Code or a receivership, foreclosure, or similar proceeding in a Federal or State court
 - The transfer must be pursuant to a plan of reorganization approved by the bankruptcy court
- Substantially all
 - Tax-free reorganization treatment applies only if the corporation to which the assets are transferred acquires **substantially all** the assets of the transferor. IRC § 354(b)(1)(A).
 - For IRS advance ruling purposes for reorganizations other than G Reorganizations, "substantially all" generally means at least:
 - 90% of the FMV of transferor's net assets,
 - and 70% of the FMV of transferor's gross assets.
 - But for G Reorganizations, a more relaxed standard applies
 - Generally 70% of the FMV of transferor's operating assets, and 50% of the FMV of transferor's gross assets held as of the measuring date

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363 Sales – G reorg (cont.)

- Substantially all (cont.)
 - A company in bankruptcy will often downsize prior to emergence by selling off or otherwise disposing of assets, causing uncertainty as to when one begins to measure the assets of the company for purposes of applying the “substantially all” test
 - PLRs have applied different measurement dates
 - The date on which the company determined it could no longer operate as a going concern
 - The date of the filing of the bankruptcy petition
 - Effective date of the bankruptcy plan
 - Assets taken out of service and held for sale have been excluded

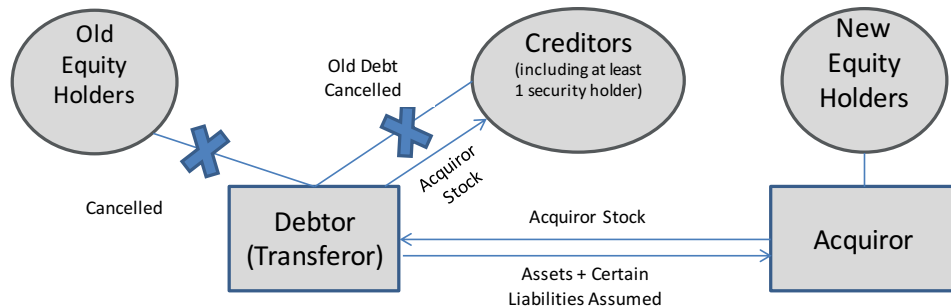
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363 Sales – G reorg (cont.)

- Continuity of Interest test
 - Of persons who, directly or indirectly, were the owners of the enterprise prior to the reorganization. Treas. Reg. §1.368-1(b).
 - A substantial part of the value of the proprietary interests in the target corporation must be preserved. Treas. Reg. §1.368-1(e).
 - COI test is generally satisfied if 40% or more of the aggregate consideration issued for the former equity consists of stock
 - In a typical reorganization, the shareholders are the owners of the proprietary interests for purposes of the COI test
 - Special rules in a G reorganization – creditors may receive proprietary interests and satisfy continuity of interest. Treas. Reg. §1.368-1(e)(6).
- Continuity of Business Enterprise test
 - satisfied if acquiror either
 - continues the target’s historic business, or
 - uses a significant portion of the target’s historic business assets in a business. Treas. Reg. §1.368-1(d)(1).

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363 Sales – G reorg (cont.)



Acquisitive Example (G reorg req'ts must be met):

1. Debtor transfers *substantially all* of its assets to Acquiror for Acquiror stock (and possibly nonstock consideration)
2. Debtor liquidates and distributes Acquiror stock (and any other consideration) in cancellation of debt not assumed
3. Existing shares are cancelled for no consideration

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363 Sales – G reorg (cont.)

- Tax consequences to Creditors and Shareholders
 - Exchange of “securities” for new “securities” or new stock by creditors is tax-free. IRC §354.
 - Tax-free to old shareholders that receive new stock. IRC §354.
 - Receipt of other property may be taxable. IRC §356.
 - Substituted basis adjusted for gain/loss recognized and any boot received (IRC §358) and tacked holding period (IRC §1223(1)) with respect to new securities or new stock received by old stock/security holders
 - Taxable to non-security holders
- Tax consequences to Target Corporation
 - Tax-free transfer of assets in exchange for stock/securities. IRC §361(a).
 - If boot is received but not distributed, gain may be recognized. IRC §361(b).
 - Tax-free distribution of new stock or securities to shareholders, security holders, and other creditors. IRC §361(c).
- Tax consequences to Acquiring Corporation
 - Issuance of its stock is tax-free. IRC §1032.
 - Acquires target corporation's tax basis and holding periods in transferred assets. IRC §§362 and 1223(2).
 - Tax attributes of target corporation carry over to acquiring corporation. IRC §381.

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363 Sales – G reorg (cont.)

- **Documentation** for the asset purchase agreement:
 - A section that meets the plan of reorganization requirements
 - the consideration paid to debtor is a sufficient amount of stock or securities of the purchaser (or, in some instances, its parent)
 - Provisions requiring liquidation of the debtor and distribution of stock and securities received from purchaser in the agreed-upon timeframe in the plan of reorganization
 - Debtor representation that all, or substantially all, of its assets are being transferred to purchaser in the transaction
 - Purchaser representation that it is treated as a corporation for tax purposes
 - A section requiring the parties to consistently report the transaction as a tax-free reorganization in all tax filings

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Biography

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John Lehrer is a Partner in Baker & Hostetler's Tax Group located in Washington, DC, and is the Tax Group Coordinator for the firm's Washington, DC office. Mr. Lehrer focuses his practice on the overall corporate structuring (domestic and international) of taxable and tax-free transactions; corporate divisions under IRC Section 355; liquidations; shareholder redemptions; entity selection; basis and E&P calculations; deemed asset purchases; tax due diligence; corporate loss limitation studies (IRC Section 382); the overall tax aspects of bankruptcy and workouts; and the consolidated return regulations.

Prior to joining Baker Hostetler, Mr. Lehrer was with the mergers and acquisitions division of an international accounting firm based at the Washington, DC national office.

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AMERICAN BANKRUPTCY INSTITUTE

Form **982**
(Rev. January 2016)
Department of the Treasury
Internal Revenue Service

Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

▶ Attach this form to your income tax return.
▶ Information about Form 982 and its instructions is at www.irs.gov/form982.

OMB No. 1545-0046

Attachment
Sequence No. **94**

Name shown on return

Identifying number

Part I General Information (see instructions)

- 1 Amount excluded is due to (check applicable box(es)):
 - a Discharge of indebtedness in a title 11 case ☐
 - b Discharge of indebtedness to the extent insolvent (not in a title 11 case) ☐
 - c Discharge of qualified farm indebtedness ☐
 - d Discharge of qualified real property business indebtedness ☐
 - e Discharge of qualified principal residence indebtedness ☐

2 Total amount of discharged indebtedness excluded from gross income **2**

- 3 Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? ☐ Yes ☐ No

Part II Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:

- | | | |
|--|------------|--|
| 4 For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property | 4 | |
| 5 That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property | 5 | |
| 6 Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge | 6 | |
| 7 Applied to reduce any general business credit carryover to or from the tax year of the discharge | 7 | |
| 8 Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge | 8 | |
| 9 Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge | 9 | |
| 10a Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. <i>DO NOT use in the case of discharge of qualified farm indebtedness</i> | 10a | |
| b Applied to reduce the basis of your principal residence. <i>Enter amount here ONLY if line 1e is checked</i> | 10b | |
| 11 For a discharge of qualified farm indebtedness applied to reduce the basis of: | | |
| a Depreciable property used or held for use in a trade or business or for the production of income if not reduced on line 5 | 11a | |
| b Land used or held for use in a trade or business of farming | 11b | |
| c Other property used or held for use in a trade or business or for the production of income | 11c | |
| 12 Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge | 12 | |
| 13 Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge | 13 | |

Part III Consent of Corporation to Adjustment of Basis of Its Property Under Section 1082(a)(2)

Under section 1081(b), the corporation named above has excluded \$ _____ from its gross income for the tax year beginning _____ and ending _____.

Under that section, the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of _____.

(State of incorporation)

Note: You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 17066E

Form **982** (Rev. 1-2016)

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.


Future developments. For the latest information about developments related to Form 982 and its instructions, such as legislation enacted after they were published, go to www.irs.gov/form982.

Purpose of Form

Generally, the amount by which you benefit from the discharge of indebtedness is included in your gross income. However, under certain circumstances described in section 108, you can exclude the amount of discharged indebtedness from your gross income.

You must file Form 982 to report the exclusion and the reduction of certain tax attributes either dollar for dollar or 33 $\frac{1}{3}$ cents per dollar (as explained below).

How To Complete the Form

IF the discharged debt you are excluding is . . .	THEN follow these steps . . .
Qualified principal residence indebtedness	<ol style="list-style-type: none"> 1. Be sure to read the definition of qualified principal residence indebtedness in the instructions for line 1e on page 4. Part or all of your debt may not qualify for the exclusion on line 1e but may qualify for one of the other exclusions. 2. Check the box on line 1e. 3. Include on line 2 the amount of discharged qualified principal residence indebtedness that is excluded from gross income. Any amount in excess of the excluded amount may result in taxable income. See Pub. 4681 for more information. If you disposed of your residence, you may also be required to recognize a gain on its disposition. For details, see Pub. 523, <i>Selling Your Home</i>. 4. If you continue to own your residence after the discharge, enter on line 10b the smaller of (a) the amount of qualified principal residence indebtedness included on line 2 or (b) the basis (generally, your cost plus improvements) of your principal residence. <div style="display: flex; align-items: center;">  <p><i>If the discharge occurs in a title 11 case, you can't check box 1e. You must check box 1a and complete the form as discussed below under A nonbusiness debt. If you are insolvent (and not in a title 11 case), you can elect to follow the insolvency rules by checking box 1b instead of box 1e and completing the form as discussed below under A nonbusiness debt.</i></p> </div>
A nonbusiness debt (other than qualified principal residence indebtedness, such as a car loan or credit card debt)	<p>Follow these instructions if you don't have any of the tax attributes listed in Part II (other than a basis in nondepreciable property). Otherwise, follow the instructions for <i>Any other debt</i> below.</p> <ol style="list-style-type: none"> 1. Check the box on line 1a if the discharge was made in a <i>title 11 case</i> (see <i>Definitions</i>, later) or the box on line 1b if the discharge occurred when you were <i>insolvent</i> (see <i>Line 1b</i>, later). 2. Include on line 2 the amount of discharged nonbusiness debt that is excluded from gross income. If you were insolvent, don't include more than the excess of your liabilities over the fair market value of your assets. 3. Include on line 10a the smallest of (a) the basis of your nondepreciable property, (b) the amount of the nonbusiness debt included on line 2, or (c) the excess of the aggregate bases of the property and the amount of money you held immediately after the discharge over your aggregate liabilities immediately after the discharge.
Any other debt	<p>Use <i>Part I</i> of Form 982 to indicate why any amount received from the discharge of indebtedness should be excluded from gross income and the amount excluded.</p> <p>Use <i>Part II</i> to report your reduction of tax attributes. The reduction must be made in the following order unless you check the box on line 1d for qualified real property business indebtedness or make the election on line 5 to reduce basis of depreciable property first.</p> <ol style="list-style-type: none"> 1. Any net operating loss (NOL) for the tax year of the discharge (and any NOL carryover to that year) (dollar for dollar); 2. Any general business credit carryover to or from the tax year of the discharge (33$\frac{1}{3}$ cents per dollar); 3. Any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge (33$\frac{1}{3}$ cents per dollar); 4. Any net capital loss for the tax year of the discharge (and any capital loss carryover to that tax year) (dollar for dollar); 5. The basis of property (dollar for dollar); 6. Any passive activity loss (dollar for dollar) and credit (33$\frac{1}{3}$ cents per dollar) carryovers from the tax year of the discharge; and 7. Any foreign tax credit carryover to or from the tax year of the discharge (33$\frac{1}{3}$ cents per dollar). <p>Use <i>Part III</i> to exclude from gross income under section 1081(b) any amounts of income attributable to the transfer of property described in that section.</p>



Certain individuals may need to complete only a few lines on Form 982. For example, if you are completing this form because of a discharge of indebtedness on a personal loan (such as a car loan or credit card debt) or a loan for the purchase of your principal residence, follow the chart, earlier, to see which lines you need to complete. Also, see Pub. 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments, for additional information.

Definitions

Title 11 Case

A *title 11 case* is a case under title 11 of the United States Code (relating to bankruptcy), but only if you are under the jurisdiction of the court in the case and the discharge of indebtedness is granted by the court or is under a plan approved by the court.

Discharge of Indebtedness

The term *discharge of indebtedness* conveys forgiveness of, or release from, an obligation to repay.

When To File

File Form 982 with your federal income tax return for a year a discharge of indebtedness is excluded from your income under section 108(a).

The election to reduce the basis of depreciable property under section 108(b)(5) and the election made on line 1d of Part I regarding the discharge of qualified real property business indebtedness must be made on a timely filed return (including extensions) and can be revoked only with the consent of the IRS.

If you timely filed your tax return without making either of these elections, you can still make either election by filing an amended return within 6 months of the due date of the return (excluding extensions). Write "Filed pursuant to section 301.9100-2" on the amended return and file it at the same place you filed the original return.

Specific Instructions

Part I



The time for making a section 108(i) election has passed. If you made an election under section 108(j) to defer income from the discharge of business debt arising from the reacquisition of a debt instrument in 2009 or 2010, don't report the amount deferred under the election in lines 1a through 1d and line 2.

Line 1b

The insolvency exclusion doesn't apply to any discharge that occurs in a title 11 case. It also doesn't apply to a discharge of qualified principal residence indebtedness (see the instructions for line 1e on page 4) unless you elect to have the insolvency exclusion apply instead of the exclusion for qualified principal residence indebtedness.

Check the box on line 1b if the discharge of indebtedness occurred while you were insolvent. You were insolvent to the extent that your liabilities exceeded the fair market value (FMV) of your assets immediately before the discharge. For details and a worksheet to help calculate insolvency, see Pub. 4681.

Example. You were released from your obligation to pay your credit card debt in the amount of \$5,000. The FMV of your total assets immediately before the discharge was \$7,000 and your liabilities were \$10,000. You were insolvent to the extent of \$3,000 (\$10,000 of total liabilities minus \$7,000 of total assets). Check the box on line 1b and include \$3,000 on line 2.

Line 1c

Check this box if the income you exclude is from the discharge of qualified farm indebtedness. The exclusion relating to qualified farm indebtedness doesn't apply to a discharge that occurs in a title 11 case or to the extent you were insolvent.

Qualified farm indebtedness is the amount of indebtedness incurred directly in connection with the trade or business of farming. In addition, 50% or more of your aggregate gross receipts for the three tax years preceding the tax year in which the discharge of such indebtedness occurs must be from the trade or business of farming. For more information, see sections 108(g) and 1017(b)(4).

The discharge must have been made by a qualified person. Generally, a *qualified person* is an individual, organization, etc., who is actively and regularly engaged in the business of lending money. This person can't be related to you, be the person from whom you acquired the property, or be a person who receives a fee with respect to your investment in the property. A qualified person also includes any federal, state, or local government or agency or instrumentality thereof.

If you checked line 1c and didn't make the election on line 5, the debt discharge amount will be applied to reduce the tax attributes in the order listed on lines 6 through 9. Any remaining amount will be applied to reduce the tax attributes in the order listed on lines 11a through 13.

You can't exclude more than the total of your (a) tax attributes (determined under section 108(g)(3)(B)) and (b) basis of property used or held for use in a trade or business or for the production of income. Any excess is included in income.

Line 1d

If you check this box, the discharge of qualified real property business indebtedness is applied to reduce the basis of depreciable real property on line 4. The exclusion relating to qualified real property business indebtedness doesn't apply to a discharge that occurs in a title 11 case or to the extent you were insolvent.

Qualified real property business indebtedness is indebtedness (other than qualified farm indebtedness) that (a) is incurred or assumed in connection with real property used in a trade or business, (b) is secured by that real property, and (c) with respect to which you have made an election under this provision. This provision doesn't apply to a corporation (other than an S corporation).

Indebtedness incurred or assumed after 1992 isn't qualified real property business indebtedness unless it is either (a) debt incurred to refinance qualified real property business indebtedness incurred or assumed before 1993 (but only to the extent the amount of such debt doesn't exceed the amount of debt being refinanced) or (b) qualified acquisition indebtedness.

Qualified acquisition indebtedness is (a) debt incurred or assumed to acquire, construct, reconstruct, or substantially improve real property that is secured by such debt and (b) debt resulting from the refinancing of qualified acquisition indebtedness to the extent the amount of such debt doesn't exceed the amount of debt being refinanced.

You can't exclude more than the excess of the outstanding principal amount of the debt (immediately before the discharge) over the net FMV (as of that time) of the property securing the debt reduced by the outstanding principal amount of other qualified real property business indebtedness secured by that property (as of that time). The amount excluded is further limited to the aggregate adjusted basis (as of the first day of the next tax year or, if earlier, the date of disposition) of depreciable real property (determined after any reductions under sections 108(b) and (g)) you held immediately before the discharge (other than property acquired in contemplation of the discharge). Any excess is included in income.

Line 1e

Check this box if the income you exclude is from discharge of qualified principal residence indebtedness. Also, be sure you complete line 2 (and line 10b if you continue to own the residence after discharge). However, if the discharge occurs in a title 11 case, you must check the box on line 1a and not this box. If you are insolvent (and not in a title 11 case), you can elect to follow the insolvency rules by checking box 1b instead of checking this box. For more information, see Pub. 4681.

Principal residence. Your principal residence is your *main home*, which is the home where you ordinarily live most of the time. You can have only one main home at any one time.

Qualified principal residence indebtedness. This indebtedness is a mortgage you took out to buy, build, or substantially improve your main home. It also must be secured by your main home. If the amount of your original mortgage is more than the cost of your main home plus the cost of any substantial improvements, only the debt that is **not** more than the cost of your main home plus improvements is qualified principal residence indebtedness. Any debt secured by your main home that you use to refinance qualified principal residence indebtedness is treated as qualified principal residence indebtedness, but only up to the amount of the old mortgage principal just before the refinancing. Any additional debt you incurred to substantially improve your main home is also treated as qualified principal residence indebtedness.

Amount eligible for the exclusion. The exclusion applies only to debt discharged after 2006. The maximum amount you can treat as qualified principal residence indebtedness is \$2 million (\$1 million if married filing separately). You can't exclude from gross income discharge of qualified principal residence indebtedness if the discharge was for services performed for the lender or on account of any other factor not directly related to a decline in the value of your residence or to your financial condition.

Ordering rule. If only a part of a loan is qualified principal residence indebtedness, the exclusion applies only to the extent the amount discharged exceeds the amount of the loan (immediately before the discharge) that is **not** qualified principal residence indebtedness. For example, assume your main home is secured by a debt of \$1 million, of which \$800,000 is qualified principal residence indebtedness. If your main home is sold for \$700,000 and \$300,000 of debt is discharged, only \$100,000 of the debt discharged can be excluded (the \$300,000 that was discharged minus the \$200,000 of nonqualified debt). The remaining \$200,000 of nonqualified debt may qualify in whole or in part for one of the other exclusions, such as the insolvency exclusion.

Line 2

Enter the total amount excluded from your gross income due to discharge of indebtedness under section 108. If you checked any box on lines 1b through 1e, don't enter more than the limit explained in the instructions for those lines. If you checked line 1a, 1b, or 1c, this amount won't necessarily equal the total reductions on lines 5 through 13 (excluding line 10b) because the debt discharge amount may exceed the total tax attributes. If you checked line 1e, this amount won't necessarily equal the total basis reduction on line 10b (which is required only if you continue to own the residence after the discharge).

See section 382(l)(5) for a special rule regarding a reduction of a corporation's tax attributes after certain ownership changes.

Line 3

You can elect under section 1017(b)(3)(E) to treat all real property held primarily for sale to customers in the ordinary course of a trade or business as if it were depreciable property. This election doesn't apply to the discharge of qualified real property business indebtedness. To make the election, check the "Yes" box.

Part II**Basis Reduction**

If you check any of the boxes on lines 1a through 1c, you can elect, by completing line 5, to apply all or a part of the debt discharge amount to first reduce the basis of depreciable property (including property you elected on line 3 to treat as depreciable property). Any balance of the debt discharge amount will then be applied to reduce the tax attributes in the order listed on lines 6 through 13 (excluding line 10b). You must attach a statement describing the transactions that resulted in the reduction in basis under section 1017 and identifying the property for which you reduced the basis. If you don't make the election on line 5, complete lines 6 through 13 (excluding line 10b) to reduce your attributes. See section 1017(b)(2) and (c) for limitations of reductions in basis on line 10a.

Line 7

If you have a general business credit carryover to or from the tax year of the discharge, you must reduce that carryover by 33 $\frac{1}{3}$ cents for each dollar excluded from gross income. See Form 3800, General Business Credit, for more details on the general business credit, including rules for figuring any carryforward or carryback.

Line 10a

In the case of a title 11 case or insolvency, the reduction in basis is limited to the aggregate of the basis of your property immediately after the discharge over the aggregate of your liabilities immediately after the discharge. However, this limit doesn't apply to a reduction in basis reported on line 5 pursuant to section 108(b)(5).

Line 10b

If box 1e is checked and you continue to own the residence after discharge, enter the smaller of:

- The part of line 2 that is attributable to the exclusion of qualified principal residence indebtedness, or
- The basis of your main home.

Part III**Adjustment to Basis**

Unless it specifically states otherwise, the corporation, by filing this form, agrees to apply the general rule for adjusting the basis of property (as described in Regulations section 1.1082-3(b)).

If the corporation desires to have the basis of its property adjusted in a manner different from the general rule, it must attach a request for variation from the general rule. The request must show the precise method used and the allocation of amounts.

Consent to the request for variation from the general rule will be effective only if it is incorporated in a closing agreement entered into by the corporation and the Commissioner of Internal Revenue under the rules of section 7121. If no agreement is entered into, then the general rule will apply in determining the basis of the corporation's property.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You aren't required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is shown as follows: **Recordkeeping**, 5 hr., 58 min.; **Learning about the law or the form**, 2 hr., 34 min.; **Preparing and sending the form to the IRS**, 2 hr., 48 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.

Checkpoint Contents

Federal Library

Federal Source Materials

Code, Regulations, Committee Reports & Tax Treaties


Final, Temporary, Proposed Regulations & Preambles

Final, Temporary & Proposed Regulations

Regs. §§ 1.1015-1 thru 1.1033(h)-1

Reg §1.1017-1 Basic reductions following a discharge of indebtedness.

Federal Regulations**Reg § 1.1017-1. Basic reductions following a discharge of indebtedness.**

 **Effective:** December 28, 2006. These regulations apply with respect to taxable years beginning after December 31, 2002. The applicability of §§1.170A-11T, 1.556-2T, 1.565-1T, 1.936-7T, 1.1017-1T, 1.1368-1T, 1.1377-1T, 1.1502-21T(b)(3)(i) and (b)(3)(ii)(B), 1.1502-75T, 1.1503-2T, 1.6038B-1T(b)(1)(ii) and 301.7701-3T will expire on December 8, 2006.

(a) General rule for section 108(b)(2)(E). This paragraph (a) applies to basis reductions under section 108(b)(2)(E) that are required by section 108(a)(1) (A) or (B) because the taxpayer excluded discharge of indebtedness (COD income) from gross income. A taxpayer must reduce in the following order, to the extent of the excluded COD income (but not below zero), the adjusted bases of property held on the first day of the taxable year following the taxable year that the taxpayer excluded COD income from gross income (in proportion to adjusted basis)—

(1) Real property used in a trade or business or held for investment, other than real property described in section 1221(1), that secured the discharged indebtedness immediately before the discharge;

(2) Personal property used in a trade or business or held for investment, other than inventory, accounts receivable, and notes receivable, that secured the discharged indebtedness immediately before the discharge;

(3) Remaining property used in a trade or business or held for investment, other than inventory, accounts receivable, notes receivable, and real property described in section 1221(1);

(4) Inventory, accounts receivable, notes receivable, and real property described in section 1221(1); and

(5) Property not used in a trade or business nor held for investment.

(b) Operating rules.

(1) *Prior tax-attribute reduction.* The amount of excluded COD income applied to reduce basis does not include any COD income applied to reduce tax attributes under sections 108(b)(2)(A) through (D) and, if applicable, section 108(b)(5). For example, if a taxpayer excludes \$100 of COD income from gross income under section 108(a) and reduces tax attributes by \$40 under sections 108(b)(2)(A) through (D), the taxpayer is required to reduce the adjusted bases of property by \$60 (\$100–\$40) under section 108(b)(2)(E).

(2) *Multiple discharged indebtednesses.* If a taxpayer has COD income attributable to more than one discharged indebtedness resulting in the reduction of tax attributes under sections 108(b)(2)(A) through (D) and, if applicable, section 108(b)(5), paragraph (b)(1) of this section must be applied by allocating the tax-attribute reductions among the indebtednesses in proportion to the amount of COD income attributable to each discharged indebtedness. For example, if a taxpayer excludes \$20 of COD income attributable to secured indebtedness A and excludes \$80 of COD income attributable to unsecured indebtedness B (a total exclusion of \$100), and if the taxpayer reduces tax attributes by \$40 under sections 108(b)(2)(A) through (D), the taxpayer must reduce the amount of COD income attributable to secured indebtedness A to \$12 ($\$20 - (\$20 / \$100 \times \$40)$) and must reduce the amount of COD income attributable to unsecured indebtedness B to \$48 ($\$80 - (\$80 / \$100 \times \$40)$).

(3) *Limitation on basis reductions under section 108(b)(2)(E) in bankruptcy or insolvency.* If COD income arises from a discharge of indebtedness in a title 11 case or while the taxpayer is insolvent, the amount of any basis reduction under section 108(b)(2)(E) shall not exceed the excess of —

(i) The aggregate of the adjusted bases of property and the amount of money held by the taxpayer immediately after the discharge; over

(ii) The aggregate of the liabilities of the taxpayer immediately after the discharge.

(4) Transactions to which section 381 applies. If a taxpayer realizes COD income that is excluded from gross income under section 108(a) either during or after a taxable year in which the taxpayer is the distributor or transferor of assets in a transaction described in section 381(a), the basis of property acquired by the acquiring corporation in the transaction must reflect the reductions required by section 1017 and this section. For this purpose, the basis of property of the distributor or transferor corporation immediately prior to the transaction described in section 381(a), but after the determination of tax for the year of the distribution or transfer of assets, will be available for reduction under section 108(b)(2). However, the basis of stock or securities of the acquiring corporation, if any, received by the taxpayer in exchange for the transferred assets shall not be available for reduction under section 108(b)(2). See §1.108-7. This paragraph (b) (4) applies to discharges of indebtedness occurring on or after May 10, 2004.

(c) Modification of ordering rules for basis reductions under sections 108(b)(5) and 108(c).

(1) In general. The ordering rules prescribed in paragraph (a) of this section apply, with appropriate modifications, to basis reductions under sections 108(b)(5) and (c). Thus, a taxpayer that elects to reduce basis under section 108(b)(5) may, to the extent that the election applies, reduce only the adjusted basis of property described in paragraphs (a)(1), (2), and (3) of this section and, if an election is made under paragraph (f) of this section, paragraph (a) (4) of this section. Within paragraphs (a)(1), (2), (3) and (4) of this section, such a taxpayer may reduce only the adjusted bases of depreciable property. A taxpayer that elects to apply section 108(c) may reduce only the adjusted basis of property described in paragraphs (a)(1) and (3) of this section and, within paragraphs (a)(1) and (3) of this section, may reduce only the adjusted bases of depreciable real property. Furthermore, for basis reductions under section 108(c), a taxpayer must reduce the adjusted basis of the qualifying real property to the extent of the discharged qualified real property business indebtedness before reducing the adjusted bases of other depreciable real property. The term qualifying real property means real

property with respect to which the indebtedness is qualified real property business indebtedness within the meaning of section 108(c)(3). See paragraphs (f) and (g) of this section for elections relating to section 1221(1) property and partnership interests.

(2) Partial basis reductions under section 108(b)(5). If the amount of basis reductions under section 108(b)(5) is less than the amount of the COD income excluded from gross income under section 108(a), the taxpayer must reduce the balance of its tax attributes, including any remaining adjusted bases of depreciable and other property, by following the ordering rules under section 108(b)(2). For example, if a taxpayer excludes \$100 of COD income from gross income under section 108(a) and elects to reduce the adjusted bases of depreciable property by \$10 under section 108(b)(5), the taxpayer must reduce its remaining tax attributes by \$90, starting with net operating losses under section 108(b)(2).

(3) Modification of fresh start rule for prior basis reductions under section 108(b)(5). After reducing the adjusted bases of depreciable property under section 108(b)(5), a taxpayer must compute the limitation on basis reductions under section 1017(b)(2) using the aggregate of the remaining adjusted bases of property. For example, if, immediately after the discharge of indebtedness in a title 11 case, a taxpayer's adjusted bases of property is \$100 and its undischarged indebtedness is \$70, and if the taxpayer elects to reduce the adjusted bases of depreciable property by \$10 under section 108(b)(5), section 1017(b)(2) limits any further basis reductions under section 108(b)(2)(E) to \$20 $((\$100 - \$10) - \$70)$.

(d) Changes in security. If any property is added or eliminated as security for an indebtedness during the one-year period preceding the discharge of that indebtedness, such addition or elimination shall be disregarded where a principal purpose of the change is to affect the taxpayer's basis reductions under section 1017.

(e) Depreciable property. For purposes of this section, the term depreciable property means any property of a character subject to the allowance for depreciation or amortization, but only if the basis reduction would reduce the amount of depreciation or amortization which otherwise would be allowable for the period immediately following such reduction. Thus, for example, a lessor cannot reduce the basis of leased property where the lessee's obligation in respect of the property will restore to the lessor the loss

due to depreciation during the term of the lease, since the lessor cannot take depreciation in respect of such property.

(f) Election to treat section 1221(1) real property as depreciable.

(1) In general. For basis reductions under section 108(b)(5) and basis reductions relating to qualified farm indebtedness, a taxpayer may elect under sections 1017(b)(3)(E) and (4)(C), respectively, to treat real property described in section 1221(1) as depreciable property. This election is not available, however, for basis reductions under section 108(c).

(2) Time and manner. To make an election under section 1017(b)(3)(E) or (4)(C), a taxpayer must enter the appropriate information on Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), and attach the form to a timely filed (including extensions) Federal income tax return for the taxable year in which the taxpayer has COD income that is excluded from gross income under section 108(a). An election under this paragraph (f) may be revoked only with the consent of the Commissioner.

(g) Partnerships.

(1) Partnership COD income. For purposes of paragraph (a) of this section, a taxpayer must treat a distributive share of a partnership's COD income as attributable to a discharged indebtedness secured by the taxpayer's interest in that partnership.

(2) Partnership interest treated as depreciable property.

(i) In general. For purposes of making basis reductions, if a taxpayer makes an election under section 108(b)(5) (or 108(c)), the taxpayer must treat a partnership interest as depreciable property (or depreciable real property) to the extent of the partner's proportionate share of the partnership's basis in depreciable property (or depreciable real property), provided that the partnership consents to a corresponding reduction in the partnership's basis (inside basis) in depreciable property (or depreciable real property) with respect to such partner.

(ii) Request by partner and consent of partnership. (A) In general. Except as otherwise provided in this paragraph (g)(2)(ii), a taxpayer may choose whether or not to request that a partnership reduce the inside basis of its

depreciable property (or depreciable real property) with respect to the taxpayer, and the partnership may grant or withhold such consent, in its sole discretion. A request by the taxpayer must be made before the due date (including extensions) for filing the taxpayer's Federal income tax return for the taxable year in which the taxpayer has COD income that is excluded from gross income under section 108(a).

(B) Request for consent required. A taxpayer must request a partnership's consent to reduce inside basis if, at the time of the discharge, the taxpayer owns (directly or indirectly) a greater than 50 percent interest in the capital and profits of the partnership, or if reductions to the basis of the taxpayer's depreciable property (or depreciable real property) are being made with respect to the taxpayer's distributive share of COD income of the partnership.

(C) Granting of request required. A partnership must consent to reduce its partners' shares of inside basis with respect to a discharged indebtedness if consent is requested with respect to that indebtedness by partners owning (directly or indirectly) an aggregate of more than 80 percent of the capital and profits interests of the partnership or five or fewer partners owning (directly or indirectly) an aggregate of more than 50 percent of the capital and profits interests of the partnership. For example, if there is a cancellation of partnership indebtedness that is secured by real property used in a partnership's trade or business, and if partners owning (in the aggregate) 90 percent of the capital and profits interests of the partnership elect to exclude the COD income under section 108(c), the partnership must make the appropriate reductions in those partners' shares of inside basis.

(iii) Partnership consent statement.

(A) Partnership requirement. A consenting partnership must include with the Form 1065, U.S. Partnership Return of Income, for the taxable year following the year that ends with or within the taxable year the taxpayer excludes COD income from gross income under section 108(a), and must provide to the taxpayer on or before the due date of the taxpayer's return (including extensions) for the taxable year in which

the taxpayer excludes COD income from gross income, a statement that—

(1) Contains the name, address, and taxpayer identification number of the partnership; and

(2) States the amount of the reduction of the partner's proportionate interest in the adjusted bases of the partnership's depreciable property or depreciable real property, whichever is applicable.

(B) Taxpayer's requirement. For taxable years beginning before January 1, 2003, statements described in §1.1017-1(g)(2)(iii)(A) must be attached to a taxpayer's timely filed (including extensions) Federal income tax return for the taxable year in which the taxpayer has COD income that is excluded from gross income under section 108(a). For taxable years beginning after December 31, 2002, taxpayers must retain the statements and keep them available for inspection in the manner required by §1.6001-1(e), but are not required to attach the statements to their returns.

(iv) Partner's share of partnership basis.

(A) In general. For purposes of this paragraph (g), a partner's proportionate share of the partnership's basis in depreciable property (or depreciable real property) is equal to the sum of—

(1) The partner's section 743(b) basis adjustments to items of partnership depreciable property (or depreciable real property); and

(2) The common basis depreciation deductions (but not including remedial allocations of depreciation deductions under §1.704-3(d)) that, under the terms of the partnership agreement effective for the taxable year in which the discharge of indebtedness occurs, are reasonably expected to be allocated to the partner over the property's remaining useful life. The assumptions made by a partnership in determining the reasonably expected allocation of depreciation deductions must be consistent for each

partner. For example, a partnership may not treat the same depreciation deductions as being reasonably expected by more than one partner.

(B) Effective date. This paragraph (g)(2)(iv) applies to elections made under sections 108(b)(5) and 108(c) on or after December 15, 1999.

(v) Treatment of basis reduction.

(A) Basis adjustment. The amount of the reduction to the basis of depreciable partnership property constitutes an adjustment to the basis of partnership property with respect to the partner only. No adjustment is made to the common basis of partnership property. Thus, for purposes of income, deduction, gain, loss, and distribution, the partner will have a special basis for those partnership properties the bases of which are adjusted under section 1017 and this section.

(B) Recovery of adjustments to basis of partnership property. Adjustments to the basis of partnership property under this section are recovered in the manner described in §1.743-1.

(C) Effect of basis reduction. Adjustments to the basis of partnership property under this section are treated in the same manner and have the same effect as an adjustment to the basis of partnership property under section 743(b). The following example illustrates this paragraph (g)(2)(v):

Example.

(i) A, B, and C are equal partners in partnership PRS, which owns (among other things) Asset 1, an item of depreciable property with a basis of \$30,000. A's basis in its partnership interest is \$20,000. Under the terms of the partnership agreement, A's share of the depreciation deductions from Asset 1 over its remaining useful life will be \$10,000. Under section 1017, A requests, and PRS agrees, to decrease the basis of Asset 1 with respect to A by \$10,000.

(ii) In the year following the reduction of basis under section 1017, PRS amends its partnership agreement to provide that items of depreciation and loss from Asset 1 will be allocated equally between B

and C. In that year, A's distributive share of the partnership's common basis depreciation deductions from Asset 1 is now \$0. Under §1.743-1(j)(4)(ii)(B), the amount of the section 1017 basis adjustment that A recovers during the year is \$1,000. A will report \$1,000 of ordinary income because A's distributive share of the partnership's common basis depreciation deductions from Asset 1 (\$0) is insufficient to offset the amount of the section 1017 basis adjustment recovered by A during the year (\$1,000).

(iii) In the following year, PRS sells Asset 1 for \$15,000 and recognizes a \$12,000 loss. This loss is allocated equally between B and C, and A's share of the loss is \$0. Upon the sale of Asset 1, A recovers its entire remaining section 1017 basis adjustment (\$9,000). A will report \$9,000 of ordinary income.

(D) **Effective date.** This paragraph (g)(2)(v) applies to elections made under sections 108(b)(5) and 108(c) on or after December 15999.

(3) Partnership basis reduction. The rules of this section (including this paragraph (g)) apply in determining the properties to which the partnership's basis reductions must be made.

(h) Special allocation rule for cases to which section 1398 applies. If a bankruptcy estate and a taxpayer to whom section 1398 applies (concerning only individuals under Chapter 7 or 11 of title 11 of the United States Code) hold property subject to basis reduction under section 108(b)(2)(E) or (5) on the first day of the taxable year following the taxable year of discharge, the bankruptcy estate must reduce all of the adjusted bases of its property before the taxpayer is required to reduce any adjusted bases of property.

(i) Effective date. This section applies to discharges of indebtedness occurring on or after October 22998.

T.D. 6158, 1/6/56 , amend T.D. 8787, 10/21/98 , T.D. 8847, 12/14/99 , T.D. 9080, 7/17/2003 ,
T.D. 9100, 12/18/2003 , T.D. 9127, 5/10/2004 , T.D. 9300, 12/7/2006 .

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2013

PLR/TAM 201321041 - 201321001

TAM 201321019 -- IRC Sec(s). 108, 02/16/2013

Technical Advice Memoranda**Technical Advice Memorandum 201321019,
02/16/2013, IRC Sec(s). 108**

UIL No.

**Income from discharge of indebtedness—date of
discharge—identifiable event—special rules for S
corps.****Headnote:**

Creditor discharged taxpayer's indebtedness on stated date, which was on or before 10/11/2001, which was crucial to determination of whether shareholder was entitled to claim additional basis in shares of S corp. stock from excluded discharge of indebtedness income under Code Sec. 108; . And, entry of court's agreed order was identifiable event that made it clear taxpayer's indebtedness would never have to be paid.

Reference(s): ¶ 1085.02(30); Code Sec. 108;**Full Text:**

<https://checkpoint.riag.com/app/view/toolItem?usid=137290s144565&feature=tcheckpoint...> 3/15/2017

Third Party Communication: None

Date of Communication: Not Applicable

Number: **201321019**

Release Date: 02/16/2013

Date: 02/12/13

Index (UIL) No: 61.22-00

CASE-MIS No: TAM-135686-12

Chief, Appeals Office Dallas, TX

Taxpayer's Name: [Redacted Text]

Taxpayer's Address: [Redacted Text]

Taxpayer's Identification No: [Redacted Text]

Year(s) Involved: [Redacted Text]

Date of Conference: [Redacted Text]

LEGEND:

Taxpayer =

Creditor =

Individual A =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Date 10 =

\$a =

b%=

c%=

\$d =

\$e =

\$f =

\$g =

\$h =

\$k =

Year 1 =

Year 2 =

ISSUE:

Whether Creditor discharged Taxpayer's indebtedness on or before October 11, 2001, resulting in discharge of indebtedness income to Taxpayer at that time.

CONCLUSION:

Creditor discharged Taxpayer's indebtedness on or before October 11, 2001, resulting in discharge of indebtedness income to Taxpayer at that time.

FACTS:

Taxpayer's shareholder relies on *Gitlitz v. Commissioner*, 531 U.S. 206 [87 AFTR 2d 2001-417] (2001), to claim additional basis in shares of S corporation stock from excluded discharge of indebtedness income under § 108 of the Internal Revenue Code (Code). The Supreme Court held in *Gitlitz* that excluded discharge of indebtedness income may be added to a shareholder's stock basis. *Gitlitz* was subsequently overturned prospectively when Congress amended § 108(d)(7)(A), effective after October 11, 2001.¹ Because the holding in *Gitlitz* applies to excluded discharge of indebtedness income arising on or before October 11, 2001, the date when Creditor discharged Taxpayer's indebtedness is crucial to the instant case.

On Date 1,² Taxpayer, an S corporation wholly owned by Individual A, entered into a Term Loan Agreement with an unrelated third-party lender (Creditor) and executed several Secured Promissory Notes (Notes) in favor of various Creditor entities, from which Taxpayer borrowed \$a at a stated interest rate of b% per year. The Notes further provided that, in addition to the b% rate of interest, the loan to Taxpayer would consist of the conveyance of a "royalty adjustment" sufficient to yield a c% internal rate of return to Creditor. Additionally, any overdue interest or principal amounts bore interest at c%.

(A) Certain provisions applied at corporate level. In the case of an S corporation, subsection (a), (b), (c), and (g) shall be applied at the corporate level, including by not taking into account under § 1366(a) any amount excluded under subsection (a) of this section. During Year 1, Taxpayer's partners experienced financial difficulties that resulted in Taxpayer defaulting on the required payments to Creditor. Taxpayer then sued the partners who failed to make payments on their obligations, and Taxpayer received a \$d jury verdict and judgment on Date 2. Because the judgment was a substantial asset of Taxpayer, Creditor decided to await the outcome of the defendants' appeal before pursuing Taxpayer's collateral securing the Notes. On Date 3, Taxpayer executed additional security agreements under the Notes in favor of Creditor.

In Year 2, the appellate court reduced the \$d judgment to \$e. Of that amount, Creditor ultimately received \$f because the judgment was divided among several parties. The appellate court suggested that the reduction in the judgment was due in part to malpractice of Taxpayer's attorneys. Thereafter, Taxpayer brought suit against its former attorneys. Creditor filed a Plea in Intervention in that litigation and claimed that Taxpayer owed Creditor principal of \$g under the Notes, plus interest, royalties and other amounts,

and asserted a right to recover those amounts from any liability adjudged to be owed to Taxpayer from its former attorneys.

On Date 4, the court entered an Order dividing the litigation into two phases, the “Main Phase” and the “Intervention Phase.” The Main Phase referred to the claim asserted by Taxpayer against its former attorneys. The Intervention Phase referred to the claim asserted by Creditor against Taxpayer.

During Date 5, Taxpayer, Creditor, and Taxpayer's former attorneys reached a basis for settlement of the litigation during mediation. The parties memorialized the basis for settlement in a Mediation Settlement Agreement, in which the parties agreed to draw up and execute a formal settlement document. That document, the Confidential Settlement and Release Agreement (Settlement Agreement), generally became effective on Date 6 (a date on or before October 11, 2001), when the last party executed the Settlement Agreement.

The Settlement Agreement provided that Creditor would receive a \$h payment from Taxpayer's former attorneys' insurers, and approximately \$ k then held in a custodial account, in exchange for Creditor cancelling the indebtedness as of the “Creditor Payment Date.” On Date 7 (a date on or before October 11, 2001), Creditor received the final settlement payment pursuant to the terms of the Settlement Agreement. On Date 8, within seven days after payment as required under the Settlement Agreement, the parties: (1) filed an Agreed Motion to Dismiss with Prejudice (Motion) and (2) requested entry of an Order Granting Agreed Motion to Dismiss with Prejudice. The Motion provided that the litigation would be “dismissed with prejudice as to all claims, cross-claims or counterclaims brought or that could have been brought” in the litigation. On Date 9 (a date on or before October 11, 2001), the court entered the Order Granting Agreed Motion to Dismiss with Prejudice (Court's Agreed Order). The Court's Agree Order provided as follows:

IT IS, THEREFORE, ORDERED that the above numbered and styled cause of action is hereby DISMISSED WITH PREJUDICE towards refilling the same as to all claims, cross-claims or counterclaims brought or that could have been brought herein, including the claims in the intervention phase, with each party bearing its own attorney's fees, costs and expenses.

Creditor included language in the Settlement Agreement that it thought would improve its position in the event that Taxpayer subsequently filed for bankruptcy protection. Creditor was concerned that the settlement payments made on behalf of Taxpayer might be viewed as preferential payments and potentially recoverable by Taxpayer's bankruptcy estate. Creditor

thought that the “Creditor Effective Date” language in the Settlement Agreement would alleviate that concern. The Creditor Effective Date, Date 10 (a date after October 11, 2001), was defined as the date five months after Creditor received payment of all amounts due under the Settlement Agreement if certain events did not occur within 91 days after payment, in which case the Creditor Effective Date would be deferred until those events were cured and no claim existed that any payments to Creditor constituted a preference, fraudulent transfer, or similar conveyance that could be avoided or otherwise restored or repaid by Creditor under any bankruptcy, insolvency, or similar law. The events that would have delayed the Creditor Effective date, if they occurred within that 91 day period, were as follows:

- 1) A filing by Taxpayer for protection under bankruptcy or similar laws, an admission by Taxpayer in writing of its inability to pay its debts, an assignment by Taxpayer for the benefit of creditors, or a consent by Taxpayer to the appointment of a receiver of itself or its property,
- 2) A filing with respect to Taxpayer of an involuntary petition under bankruptcy or similar laws or an order appointing a receiver of its property, or
- 3) An assignment by Taxpayer of its claims against Creditor, which likewise were to be released under the Settlement Agreement on the Creditor Effective Date.

The Settlement Agreement further stated: [A]ny release... which is effective as of the [Creditor] Payment Date shall be “null, void and of no force or effect ab initio as of the [Creditor] Payment Date if prior to the [Creditor] Effective Date any of the payments to the [Creditor]... shall have been ordered by a court of competent jurisdiction in connection with a bankruptcy or insolvency proceeding of [Taxpayer] to be avoided, rescinded, set aside or otherwise recovered, restored or repaid by recipient to [Taxpayer] or their respective bankruptcy estate(s) under any bankruptcy, insolvency or similar law.

In the instant case, none of these events occurred.

In short, the facts of the instant case reveal several possible dates when Creditor might be viewed as having discharged Taxpayer’s indebtedness. These possible dates include the following:

- 1) On Date 6 (a date on or before October 11, 2001), when Taxpayer, Creditor and other parties executed the Settlement Agreement,
- 2) On Date 7 (a date on or before October 11, 2001), when Creditor received a payment of \$h from the custodial account and a payment of \$k from Taxpayer’s former attorneys’ insurer,

3) On Date 9 (a date on or before October 11, 2001), when Court's Agreed Order was entered, or


4) On Date 10 (a date after October 11, 2001), when the Creditor Effective Date was met because certain events did not occur.

Taxpayer argues in the alternative. First, the execution of the Settlement Agreement on Date 6 created a binding obligation on Taxpayer to compromise and settle the debt, and the execution constituted an "identifiable event" for purposes of determining when a discharge of indebtedness occurred. Second, the discharge occurred on Date 7, when all obligations under the Settlement Agreement were fully performed, including Creditor's receipt of the settlement payment. Third, the discharge occurred on Date 9, when the Court's Agreed Order was entered.

The Service argues that Taxpayer must first meet the Creditor Effective Date provision and that as a result of Taxpayer meeting that provision on Date 10 (a date after October 11, 2001), discharge of indebtedness occurred at that time.

Although Taxpayer and Appeals do not agree on the exact amount of discharge of indebtedness income, the parties agree that Taxpayer's indebtedness owed to Creditor exceeded the payments that Creditor received under the Settlement Agreement.

LAW AND ANALYSIS:

 Section 61(a)(12) of the Code provides that gross income includes income from the discharge of indebtedness.

In *United States v. Kirby Lumber Co.*, 284 U.S. 1 [10 AFTR 458] (1931), a corporation repurchased its bonds for an amount less than their par value. The Court held that this resulted in an accession to wealth because, to the extent of the difference, the corporation's assets had been released from a liability.

In general, if a taxpayer repays its debt for less than the amount due, income from the discharge of indebtedness arises. If actual repayment on a debt is not made, income from discharge of indebtedness arises when it becomes clear that the debt will not be paid. Addressing when a discharge occurs that results in discharge of indebtedness income, the Tax Court stated in *Cozzi v. Commissioner*, 88 T.C. 435, 445 (1987):

The moment it becomes clear that a debt will never have to be paid, such debt must be viewed as having been discharged. The test for determining such moment requires a

practical assessment of the facts and circumstances relating to the likelihood of payment. *Brountas v. Commissioner*, 74 T.C. 1062, 1074 (1980), *supplemental opinion* to 73 T.C. 491 (1979), *vacated and remanded on other grounds* 692 F.2d 152 [50 AFTR 2d 82-5900] (1st Cir. 1982), *affd. in part and revd. in part on other grounds sub nom. CRC Corp. v. Commissioner*, 693 F.2d 281 [50 AFTR 2d 82-6105] (3d Cir. 1982); *see Bickerstaff v. Commissioner*, 128 F.2d 366, 367 [29 AFTR 508] (5th Cir. 1942); *Kent Homes Inc. v. Commissioner*, 55 T.C. 820, 828-831 (1971), *revd. on other grounds* 455 F.2d 316 [29 AFTR 2d 72-585] (10th Cir. 1972); *Cotton v. Commissioner*, 25 B.T.A. 1158 (1932). Any “identifiable event” which fixes the loss with certainty may be taken into consideration. *United States v. S.S. White Dental Mfg. Co.*, 274 U.S. 398 [6 AFTR 6750] (1927).

Thus, the inquiry in the instant case is when did it become clear that Taxpayer would never have to pay the indebtedness. For the reasons explained below, Date 9 is when the discharge of indebtedness occurred, and the entry of the Court's Agreed Order is the “identifiable event” that fixes Creditor's loss with certainty.

It is clear that the Settlement Agreement provides for Creditor to receive a payment from Taxpayer's former attorneys' insurers in exchange for Creditor's cancellation of Taxpayer's indebtedness. Taxpayer first argues that the execution of the Settlement Agreement on Date 6 created a binding obligation to compromise and settle the debt. Thus, the execution constituted an “identifiable event” for purposes of determining when a discharge of indebtedness occurred. *See Cozzi v. Commissioner, supra*. However, the courts are in agreement that if the settlement agreement is contingent upon future events, those events or conditions must first be met. In the present situation, the mere execution of the Settlement Agreement does not fulfill all of Taxpayer's obligations, including payment, under the Settlement Agreement. *See, Walker v. Commissioner*, 88 F.2d 170 [19 AFTR 99] (5th Cir. 1937), *affg. White v. Commissioner*, 34 B.T.A. 424 (1936), (an agreement to cancel a debt in the future is not sufficient to discharge the indebtedness immediately if the cancellation is contingent upon future events).

Taxpayer's next argument provides that, in general, if a taxpayer repays its debt for less than the amount due, income from the discharge of indebtedness arises at the time the debt is satisfied. Thus, Taxpayer argues that on Date 7, when the final payment is received, it becomes clear that a debt will never have to be paid and that payment is the “identifiable event” that results in discharge of indebtedness income. *See Cozzi v. Commissioner, supra*. In the present situation, the Settlement Agreement requires that the parties file the Motion and request entry of the Court's Agreed Order after payment is received. Thus, all conditions


in the Settlement Agreement were not met when payment was received. See, *Walker v. Commissioner, supra*.

The Service presents a reasonable argument that the Creditor Effective Date provision created a condition that must have been met before a discharge of indebtedness could have occurred. Under this approach, the discharge of indebtedness would have occurred on Date 10 (a date after October 11, 2001). As explained above, if Taxpayer filed for bankruptcy protection and the settlement payment was viewed as a preferential payment and recovered by Taxpayer's bankruptcy estate, the Settlement Agreement would be rendered "null, void and of no force or effect." If this occurred, Creditor could have continued with the litigation to pursue collection of the entire indebtedness owed, including amounts in excess of the compromised amount negotiated under the Settlement Agreement. If the litigation had continued, it would not be clear that the debt would never have to be paid. See *Cozzi v. Commissioner, supra*. Also see, *Walker v. Commissioner, supra*.

However, we conclude that Taxpayer has the better argument that the discharge of indebtedness occurred on Date 9, when the Court's Agreed Order was entered. On Date 9, the Court's Agreed Order dismissed with prejudice all "claims cross-claims or counterclaims brought or that could have been brought herein, including the claims in the intervention phase..." At this point in time, neither Taxpayer nor Creditor could ever again sue for claims arising out of the same cause of action. If Taxpayer had violated the terms of the Settlement Agreement, which it did not, Creditor's only recourse would have been to sue to enforce the terms of the Settlement Agreement. Creditor could not have sued to recover any amount in excess of the compromised amount negotiated under the Settlement Agreement. Thus, the entry of the Court's Agreed Order locked the parties into the compromised amount negotiated, and received, under the terms of the Settlement Agreement.

The Creditor Effective Date provision simply had no effect on the finality of the Court's Agreed Order terminating all of Creditor's rights to seek additional amounts owed on the indebtedness. In addition, if Taxpayer's bankruptcy estate had recovered Taxpayer's payment to Creditor, the Creditor Effective Date would have given Creditor no rights greater than the rights available to any creditor under general bankruptcy law. Further, the faint possibility of such an event occurring would be highly remote and would not affect when a discharge occurs for federal tax purposes. See *Milenbach v. Commissioner*, 318 F.3d 924, 936 [91 AFTR 2d 2003-818] (9th Cir. 2003), (repayment of indebtedness need not have become absolutely impossible before it is considered discharged for federal income tax purposes,... and slim possibility that debt may still be enforced does not prevent it from being treated as discharged).

Accordingly, based on the facts and circumstances presented, the discharge of indebtedness occurred on Date 9. The entry of the Court's Agreed Order is the identifiable event that makes it clear that Taxpayer's indebtedness would never have to be paid.

¹  Section 108(d)(7) provides, in part:

² All "Dates" are in chronological order, *i.e.*, Date 1 is before Date 2, Date 2 is before Date 3...

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