AMERICAN BANKRUPTCY INSTITUTE

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Tax Traps for Bankruptcy Attorneys

Hosted by the Commercial and Regulatory Law & Financial Advisors and Investment Banking Committees

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CONCURRENT SESSION

2023

Tax Traps for Bankruptcy Attorneys

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1

AGENDA

- Determining Tax Liability
- Liability Management Transactions – "Significant Modifications," CODI, Debt-Equity, and Section 382
- Flow-Through Issues
- Cross-Border Structuring and Engagement Issues
- Tax Treatment of Bankruptcy Costs
- Qualified Real Property Business Indebtedness
- State Tax Consideration

2

Tax Monsters Under the Bed

- Tax issues are **everywhere** in restructuring and liability management transactions.
- Everything comes back to the fundamental point: Even if you don't think what you're doing should or would have tax consequences, you should make sure a tax person has reviewed it first.
- The purpose of this presentation is to highlight some of the most common and recurring issues (especially where they tend to be surprising to non-tax people).
- We're not doing substantive tax analysis here—we are highlighting situations/risks so that you know enough to issue spot.

3

Determining Tax Liability

4

Determination of Tax Liability in Bankruptcy - §505

Request for Determination

- The bankruptcy court may determine the amount or legality of any tax - §505(a)
- A trustee may request a determination from the governmental unit of any unpaid tax liability incurred during the administration of the case - §505(b)
  - Strict time deadlines that may be extended by the Court

Discharge of Tax Liability

- If the trustee makes a request for determination, then the debtor is discharged from any tax liability upon:
  - Payment of the tax shown on such return if such governmental unit does not meet the requisite deadlines;
  - Payment of the tax determined by the Court after a hearing and completion of an audit; or
  - Payment of the tax determined by such governmental unit to be due.

5

Taxes as an Administrative Expense - §503(b)(1)(B)

Taxes that Are Administrative Expenses

- Any taxes incurred by the estate that are not excluded below
- Any taxes resulting from an excessive allowance of a tentative carryback adjustment that the estate received
- Any fine, penalty, or reduction in credit relating to a tax that is an administrative expense

Taxes that Are Not Administrative Expenses Include: (§507(a)(8) – 8th Priority)

- A tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition
- A property tax incurred before the commencement of the case and payable without penalty one year before the date of the filing of the petition
- Withholding taxes

6

Timeframe for Tax Administrative Claim - §503(b)(1)(D)

- A governmental unit is not required to file a request for the payment of a tax as a condition of its being an allowed administrative expense.
- As such, there is technically no time limit for a government to file for administrative expenses for taxes.

7

Liability Management Transactions – "Significant Modifications," CODI, Debt-Equity, and Section 382

8

"Significant Modifications" – Potential Implications

- What are we talking about: "Uptiers," amend-and-extends, dropdown/"unsubs"/roll-ups/etc., in addition to more comprehensive debt workouts that occur in or out of court.
- Basic issue: Whenever you do anything that "modifies" a debt instrument, several things *may* happen:
  - There can be a deemed debt-for-debt exchange that triggers cancellation of indebtedness income ("CODI").
  - These transactions could destroy tax fungibility of a debt series (i.e., require the issuance of a new CUSIP, with the associated consequences on liquidity) and generate original issue discount ("OID") for tax purposes (with negative creditor consequences).
  - The debt might be subject to "debt-equity" testing (i.e., debt recharacterized as equity for tax purposes).

9

"Significant Modifications" – What Triggers Them?

- "Modifications" are way broader than you might think, including:
  - Anything that changes the *all-in* yield on a debt instrument, *including* the payment of one-off fees (consent fees, RSA fees, etc., though we generally get comfortable ignoring payment of professional fees).
  - Anything that changes the collateral profile of a debt instrument, *including* through intercreditor agreements. "Layering" in uptier transactions, addition/removal of guarantors in unsub transactions, pledging unencumbered assets, etc., are all relevant.
  - Anything that modifies any due date on a debt instrument (maturity extensions, shortened maturity dates, changes to interest and amortization schedules, etc.).
  - Changes to makewhole provisions, the interest rate "grid," covenants, etc.
- If there is a modification, there are certain black-and-white mathematical tests, and more "qualitative" "facts-and-circumstances" tests, we consider to determine whether a modification is "significant." If a modification is "significant," then there is a deemed debt exchange. **These tests can and frequently do result in deemed debt exchanges even if the amount of outstanding debt doesn't change, the terms don't change, etc.**

10

"Significant Modifications" – Examples

- *Change in Yield.* "Per se" sig mod if a debt instrument's remaining yield to maturity (YTM) changes by more than the greater of (a) 25 bps or (b) 5% of the annual yield of the instrument.
  - Payment of a one-time consent or RSA fee: treated as a payment of additional interest amortized over the remaining life of the debt, so fees paid closer to maturity are worse.
  - "Deemed" fees: Some practitioners get concerned about "disguised" fees, especially in drop-down refinancing transactions where new debt is issued by an entity that is separate from the issuer of the existing debt. Example: Debtor (Parent) has $300 of unsecured debt trading at 50% ($150). In a drop-down transaction, a subsidiary of Parent that is released from the existing debt (Sub) issues $80 of new secured debt (expected to trade at par) in exchange for $100 of Parent debt. The form of the transaction results in $20 of discount capture and CODI. However, Sub debt worth $80 was used to acquire Parent debt of $100 worth $50, and some people believe the $30 "premium" could be treated as a fee paid on the debt that is *not* exchanged, giving rise to a deemed exchange on the $200 of Parent debt that was not in the transaction. **Meaningful disagreement about the level of risk on this issue among the tax bar**.
  - Changes in the amount outstanding on the debt will of course change the yield, and rollup/uptier transactions could have similar "deemed" transaction issues.
  - Grants of equity kickers and similar may be treated as fees for these purposes.
  - Multi-year look-back aggregation rule for this test.

11

"Significant Modifications" – Examples (cont'd)

- *Change in Collateral, Guarantors, Priority Level, Etc.* Sig mod if there is a "change in payment expectations," which evaluates whether a transaction causes the debt to move from being "primarily speculative" to not, or vice versa.
  - Facts and circumstances test that looks at trading values, subjective expectation of repayment, credit ratings, etc. Often the case that tax people get comfortable the debt was "primarily speculative" before and after the transaction where it is the debt that is being layered/having security removed/etc.
  - Removal of guarantors is subject to a different test if the guarantor is actually a co-obligor for federal income tax purposes, as noted below.
- *Timing Changes.* Changing the payment of *any* payment (interest, amortization, or maturity) is a sig mod if it results in a "material deferral of scheduled payments".
  - Safe harbor: Lesser of five years or 50 percent of original term of debt instrument.
  - All deferrals are aggregated for this purpose, which means that the deferral of one interest payment in Year 1 arguably counts against the deferral of maturity from Year 3 to Year 4, etc. Significant diligence exercise.
  - *Acceleration* of payments changes are tested under the "general rule" of economic significance rather than some kind of inverse to the safe harbor.
- *Changes in "customary accounting or financial covenants."* Not sig mods (even though they are often quite critical), but there is question about what that rule covers.

12

"Significant Modifications" – Examples (cont'd)

- *Debt/Equity.* Sig mod if the modified instrument is equity for federal income tax purposes rather than debt.
  - "Equity cushion" is a very important debt/equity test for tax purposes.
  - *Generally,* the decline in a debtor's financial condition since issuance of the debt instrument is not taken into account in testing whether the modified instrument is equity.
  - *However*, if there is an addition/removal of a co-obligor, decline in financial condition *will* be taken into account, which requires careful analysis in unsub-type transactions. Changes in the debt from "recourse" to "nonrecourse" debt have a similar issue, with potentially surprising results if there are any "disregarded" entities involved for tax purposes.
- *General Rule*. Where one of the specific rules does not apply, any modification is tested under a general rule of economic significance.
  - There can be debates about whether changes in terms are covered by the "customary accounting or financial covenant" rule or this general rule.

Bottom Line: Almost anything can be a sig mod. Make sure your tax people know about ANYTHING that could implicate these rules!

13

"Significant Modifications" – So What?

- If there is a sig mod, the modified debt instrument is deemed to be exchanged for a new debt instrument (even if nothing about the debt instrument has changed, e.g., in the context of a fee payment). This can result in CODI (and attendant OID) or recharacterization as equity.
- If debt is "publicly traded," CODI and OID will be based on the difference between the amount outstanding on the debt and the *trading price/quotes* of (a) the "new"/modified debt, if it is publicly traded or (b) the "old" debt, if the new debt isn't publicly traded.
- "Publicly traded" = (a) greater than $100M and (b) there are any trades ***or mere "indicative quotes" on pricing services*** like BVAL, Markit, or similar, ***even if you know the debt doesn't trade***.
  - Yes, single-holder ABLs occasionally have indicative quotes.
  - Note that if the "new" debt is less than $100M, the trading price of the "old" debt controls ***even if*** the new debt trades at par.
  - Mere "indicative quotes" provide a rebuttable presumption, so very strong valuation evidence may be able to lead to a different result, but this is a difficult standard.
  - There is an anti-abuse rule that ignores artificial efforts to avoid trading and ignores artificial trades that are tax-driven.

14

"Significant Modifications" – So What? (cont'd)

- Examples:
  - There is a sig mod on debt of $200M that is trading for 50% ($100M). There is $100M of CODI and the "new" debt is treated as having been issued with $100M of OID for tax purposes.
  - Debtor has $200M of debt outstanding that is trading for 50%. In a rollup, $80M of this debt is exchanged for $80M of new debt that trades at par, and the old debt's trading price declines to 30%. Because the new debt is less than $100M, the trading price on the old debt controls and there will be CODI and OID.
- In an out-of-court transaction, CODI will either (a) result in taxable income that is offset by tax attributes to the extent available and otherwise result in tax liability; or (b) be excluded from taxable income to the extent the company is insolvent for tax purposes immediately before the transaction.

15

"Significant Modifications" – So What? (cont'd)

- If the insolvency exclusion applies, the CODI reduces tax attributes at the end of the tax year.
  - ***Significant, complicated, time-intensive modeling*** that requires, among other things, a full investigation of company transactional history and intercompany accounting, is necessary to determine the consequences of this.
  - There are substantial planning opportunities that can mitigate the effect of excluded CODI, but some of that planning can only be done on or before the date of the transaction that triggers the CODI, which means there is significant diligence that must occur ***before*** the transaction occurs.
  - ***Tax attributes can include things like accounts payable and inventory that will translate to immediate cash tax liability at the beginning of the calendar year, as well as other short/medium term "land mines" that result in cash tax, not just NOLs and similar***.
- Determining whether the insolvency exclusion applies is highly fact-dependent:
  - Value of assets vs. value of liabilities. Note, no "ability to pay debt as they come due" concept, here, which means a debtor may be able to take the insolvency exclusion and still argue that they are in compliance to make solvency reps and similar.
  - Book values irrelevant.
  - Contingent liabilities cannot be taken into account unless they have a greater-than-50% likelihood of coming to pass, which means market value may not be a good proxy for insolvency.

16

"Significant Modifications" – So What? (cont'd)

- In an in-court transaction, the bankruptcy exclusion rule applies without needing to make a value determination (but attribute reduction remains relevant).
- If there is CODI, the "new"/modified debt will also have an equivalent amount of tax OID, which is subject to comparatively unfavorable tax rules to creditors (treated as additional interest subject to ordinary income and taxed on a "dry income"/accrual basis).
- The presence of tax OID could make the interest non-deductible to the company under the "AHYDO rules."
- Query whether tax OID might raise a concern about disallowance in a subsequent restructuring (though cases in the Second and Fifth Circuits, as well as the Res Cap bankruptcy, have held that "tax OID" is not unmatured interest for purposes of the bankruptcy code).
- If the debt is recharacterized as equity because of the sig mod, there can be dramatic issues.
  - Section 382 considerations (discussed below).
  - Payments on the instrument may become subject to dividend tax rules (withholding, etc.).
  - If the issuer of the debt is not the parent of the tax group, could result in tax deconsolidation, the creation of a tax partnership between the debtor and the creditor, and other outcomes of this nature that can have very surprising and negative results.

17

Debt/Equity

- Any new debt instrument will be subsequent to debt/equity testing.
- Critical issue: Is there an "equity cushion."
  - This has to be tested for each new ***funding amount,*** even under existing facilities (e.g., ABL draws, new money issuances in a senior facility, etc.).
  - No "hard and fast" rule but, in general, people start getting nervous at about 80% loan-to-value and extremely nervous at 90% loan-to-value.
  - Differing practitioner views on whether other considerations (subjective intent to repay, objective likelihood of repayment, etc.) can overcome the lack of a sufficient equity cushion (there is a very bad court case that implies that it may be impossible to overcome the lack of an equity cushion).
- Another critical issue: Cannot be mandatorily convertible to equity.
  - Most common problem area: Senior bridge loans/DIP facilities that are expected to equitize.
  - Typical approach: Debt instrument must be payable in cash by its own terms, but restructuring support agreement or similar that is entered into contemporaneously can contemplate equitization
  - However, some practitioners believe that if, at issuance, equitization is likely to occur taking all facts into account, the instrument will be treated as equity.

18

Section 382

- If a company has an "ownership change," Section 382 imposes a limitation on a company's ability to utilize its tax attributes—including, under certain circumstances, "built-in losses" in assets (e.g., the ability to claim a loss if an asset with tax basis of $100 is sold for $50).
- Equity issuances in liability management transactions—whether actual or deemed—can trigger an ownership change and must be carefully monitored, especially if a subsequent transaction that relies on tax attributes might be necessary.
  - Obvious and critical example: If an ownership change occurs, a company's ability to use its tax attributes to sell or dispose of assets in a subsequent transaction could be limited, which may ultimately result in a "stranded tax" situation in the worst circumstances.
- Ownership changes occurring out of court are subject to less favorable rules than ownership changes occurring pursuant to a plan of reorganization in-court, which is why it is important to try to delay ownership changes.
- In the "best-case" scenario, ownership changes occurring pursuant to a bankruptcy plan may not result in any limitation on the ability to utilize tax attributes pursuant to Section 382(l)(5). Navigating the eligibility requirements and limitations of Section 382(l)(5) are complex and beyond the scope of this panel, other than to say that it's not an option at all if there is an "early" ownership change.

19

Flow-Through Issues

20

Flow-Through Debtors Raise Difficult Issues

- Where debt has been issued by a "flow-through" tax partnership, particular difficult issues can exist.
- CODI will "flow through" from the debtor to its shareholders, potentially leading to substantial income events for a debtor's shareholders.
  - It is true that the shareholder will ultimately have a loss from writing off its investment, but CODI is typically "ordinary" income, taxable at individual rates, and the equity loss will be capital and unavailable to offset this income.
  - Equity holders may have losses that have been allocated by the debtor and previously unused, but this will be a case-by-case determination.
  - Note that CODI of S-Corporations does *not* flow through—one area where S-Corporations are more advantageous than tax partnerships.
- An equity holder may be able to "block" CODI by transferring its interest to a corporate entity, but this can raise other issues.
  - If an equity holder has a "negative capital account," which tends to occur where (a) the equity holder has used losses to offset other income or (b) there have been debt-financed distributions, "blocking" will "recapture" this negative capital account.
  - The IRS may attempt to challenge the "blocking" transaction, especially if it happens in close proximity to a transaction. (Earlier is better, which emphasizes the need to be running tax diligence and analysis early.)
  - Once you "block," you are stuck in corporate solution, which will be suboptimal if the situation turns around.
  - The "blocker" can, in certain circumstances, be left with its own "stranded" tax liability, which leads to potential litigation risk. This can occur if a transaction is ultimately structured in a way that is treated as an asset sale that results in taxable income other than CODI.

21

Flow-Through Debtors Raise Difficult Issues (cont'd)

- Transactions may also sometimes be structured as asset sales for tax purposes that can give rise to income. In some cases, this may be more favorable than CODI, because the income may be capital in nature (such that the investment loss can offset it), but significant analysis is necessary.
- REITs can face particularly vexing issues.
  - The bankruptcy process may simply preclude a REIT from being able to pay the dividends necessary to preserve REIT status.
  - Some, but not all, CODI is excluded from REIT taxable income determinations.
  - Restructuring transactions that are treated as asset sales can give rise to substantial capital gain issues for REITs.
  - All-in-all, distressed REITs tend to find themselves in an extremely challenging posture.

22

Cross-Border Structuring and Engagement Issues

23

Cross-Border Guarantees/Collateral Packages

- The treatment of foreign subsidiaries on guarantor/collateral packages is always a sore point.
- Historic standard: Foreign subs did not guarantee U.S. debt instruments or provide collateral support and pledges of the stock of first-tier foreign subsidiaries were limited to ~65%.
- Changes to U.S. tax rules since 2018 mean that it is ***normally, but not always***, ok for a U.S. borrower to provide a pledge of 100% of the stock of its first-tier foreign subsidiaries. Diligence is still needed but this is now a common "give" for DIPs, adequate protection packages, and liability management/rescue financing debt.
- ***It is still generally NOT ok for foreign subsidiaries to provide upstream guarantees/collateral support in the absence of significant diligence/analysis***.
  - "Transfer pricing" rules will often require the U.S. parent to pay a guarantee fee to the subsidiary. This fee will result in tax in the subsidiary jurisdiction AND potentially in the U.S., and if the fee is not actually paid, the foreign subsidiary will also be treated as paying a dividend to the U.S. (with attendant withholding issues).
  - Non-tax "corporate benefit" rules may essentially render these kinds of guarantees invalid or even potentially illegal.
  - These analyses can take a ***very long time*** because of the need to get non-U.S. advice, and the transfer pricing analyses often lead to very inconsistent outcomes from case to case.

24

The Tax Boogeyman – U.S. Inversion Rules

- The U.S. "inversion" rules will operate to treat a non-U.S. corporation as a U.S. corporation for federal income tax purposes.
- These rules can apply in bizarre and, frankly, ridiculous, ways in restructuring transactions involving non-U.S. parent companies with U.S. subsidiaries that have issued debt.
- Without getting into the technical details, the basic problem is that, in any situation where creditors of a U.S. subsidiary are receiving equity of a non-U.S. parent because of the U.S. debt, the non-U.S. parent could ***potentially*** be subject to the inversion rules. This is true ***even if*** creditors of other entities in the enterprise are receiving the majority of the equity.
- The ***best defense*** against this outcome is to ensure that creditors equitize into the ***pre-existing*** parent entity, ***rather than*** having the existing parent transfer equity in a U.S. entity to a different entity (whether a newco or a subsidiary).
- However, this can be very difficult to navigate if the corporate/restructuring law of the parent do not permit the parent to continue to exist or require affirmative shareholder votes to permit the elimination of existing equity holders.
- Failing the inversion rules will cause a company's worldwide enterprise to be subject to U.S. tax, both currently and in the future—it's potentially a very bad outcome.

25

Cross-Border Intercompany Claims and Transfer Pricing

- Cross-border intercompany claims can have ***substantial*** tax consequences in the U.S. and other jurisdictions.
- Critical to involve tax in cash planning/movement considerations. For example, ***it may not be ok*** for all cash flows to be done via intercompany claims, particularly if those intercompany claims may not be able to be satisfied, but this could conflict with typical cash management expectations where non-debtors are involved.
- Many non-U.S. jurisdictions do ***not*** have rules that allow for cross-border intercompanies to be released without tax consequence: can result in tax liability, dividends (and withholding), and similar considerations.
- Additionally, a company's "ordinary-course" operational profile may be extremely sensitive to tax transfer pricing analysis that cannot be modified without creating substantial multi-jurisdictional audit risks.
  - Transfers of goods and services may be subsequent to locked-in "cost-plus" arrangements that generate intercompany liabilities.
  - Cross-border license and royalty payments are typically very tax-sensitive.
  - Multi-jurisdiction "profit sharing" agreements may ***preclude*** the creation of transaction-by-transaction, dollar-by-dollar intercompany liabilities, because the relevant entities have agreed to simply divvy up profits and losses in a partnership-like manner (and this profit sharing will itself generate intercompany liabilities).
- So, get tax involved early and do not assume the company's practices can be changed or relegated to pre- vs post-petition treatment.

26

Board Membership, Professional Fee Payments, Etc.

- Be aware of the mundane issues.
- Appointment of U.S. people to non-U.S. boards can raise fairly meaningful local law employment/income tax considerations, including tax gross-up issues, that should be well-considered in the engagement process (and your U.S tax colleagues won't be able to answer the questions).
- Carefully consider which entity is retaining, and paying for, professional fee expenses. A misstep can cost a ***substantial*** amount of money from a value-added tax (VAT) perspective. Get tax involved on this ***before*** you execute the engagement letter, if possible.

27

Tax Treatment of Bankruptcy Costs

28

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Tax Treatment of Bankruptcy Costs

- Amounts paid to ***"institute or administer"*** Chapter 11 bankruptcy proceedings are required to be capitalized (i.e., non-deductible).
- NOT a *per se* capitalization rule. Instead, a "look-through" approach → Amounts that do NOT "institute or administer" Chapter 11 bankruptcy proceedings may be deductible.
- Regulations, case law, and IRS authority = complex & ambiguous, but ***3 basic cost categories*** can be extracted from authority:
  1. Currently deductible amounts
  2. Amounts that must be capitalized & amortized
  3. Amounts that must be permanently capitalized

29

Examples of Costs that "Institute or Administer" Chapter 11

- Preparation + filing of Chapter 11 petition
- Obtaining extension of exclusivity period
- Formulating plan(s) of reorganization
- Analyzing proposed plans of reorganization
- Contesting or obtaining approval of plan

30

Examples of Costs that do NOT "Institute or Administer" Chapter 11

- **Regular Business Operations during Bankruptcy**
  - First-day orders generally remove bankruptcy court from day-to-day business, but court approval still required for non-routine action.
  - Where court approval is required, bankruptcy counsel and court are involved. Does not mean associated expenses automatically relate to "administration" of the bankruptcy, but adds practical challenges.
  - Defense against involuntary Chapter 11 proceedings – likely viewed as ordinary & necessary business response.
- **Debt Restructuring Costs**
  - Facilitate the borrowing, not the bankruptcy. Capitalize/amortize over new debt term under applicable debt rules.
  - If debt is repaid or refinanced in connection with Chapter 11 bankruptcy, need to determine whether unamortized costs become deductible or are recapitalized to new debt.
- **Asset Sales**
  - Costs related to Section 363 or other asset sales as part of Chapter 11 plan are arguably selling expenses that reduce amount realized on asset sale.

31

Examples of Costs that do NOT "Institute or Administer" Chapter 11 (cont.)

- **Lease Renegotiation Costs**
  - Arguably allocated to lease contracts and amortized under applicable tax accounting rules.
  - Similar analysis arguably applies for other long-term contracts (e.g., collective bargaining agreements).
- **Claims Reconciliation Costs**
  - The cost of claims reconciliation activities performed by the debtor's own employees would be deductible.
  - Cost of paying an outside contractor to provide same reconciliation services may be deductible under regulatory exception for secretarial, clerical, and administrative services if sufficiently ministerial.
- **Liquidating Bankruptcies**
  - Not a lot of guidance.
  - One logical approach = add costs to asset basis – reduces ultimate gain or increases loss on sale/liquidation.
  - Alternative more conservative approach = capitalize costs as a separate, non-amortizable asset, which may or may not produce tax benefit & may be unduly harsh.
  - Tax deductions may have less practical impact in liquidating bankruptcy where taxpayer sells assets and pays debt. Cost/benefit considerations may inform approach and effort.

32

Examples of Costs that do NOT "Institute or Administer" Chapter 11 (cont.)

- **Tort Claim Resolution**
  - Expenses incurred in connection with a bankruptcy to resolve tort claims may be deductible.
  - Mass tort bankruptcies instituted to resolve tort claims ("bet-the-company" litigation) arguably give rise to largely deductible versus capital costs.
  - Caveat = amounts would have been deductible business expenses if bankruptcy had not occurred.
  - Examples of deductible expenses include (without limitation):
    - Amounts incurred to review complaints filed in non-bankruptcy court.
    - Amounts incurred in attempt to settle claim outside of bankruptcy proceeding.
    - Amounts incurred specifically to formulate, contest, or obtain approval of the portion of the Chapter 11 plan that resolves tort liabilities (subject to practical challenges re: isolating and substantiating tort-related costs from general plan costs if time entries are lumped)

33

Practical Takeaways – Transaction Cost Analysis

- Fee applications and underlying time records will generally be taxpayer's primary basis for substantiating expenses.
- GAAP "reorganization items" = common starting point for transaction cost analysis and IRS audit adjustment. Therefore, when reporting professional fees on fee applications:
  - Categorize ordinary business expenses as such (vs. lumping into general bankruptcy categories that get booked to bankruptcy G/L accounts for financial reporting purposes)
  - Clearly categorize bankruptcy-related workstreams that do not relate to institution/administration of the Chapter 11 proceedings for U.S. federal income tax purposes.
- Investment in transaction cost analysis effort should be informed by cost/benefit considerations.
  - What is value of additional deductions in post-petition, pre-confirmation tax years?
  - Value will depend in part on tax consequences of Chapter 11 plan, including (as applicable):
    - Taxable COD
    - Gain/loss on related asset sales
    - Elimination of NOL carryovers and/or other attributes related to exclusion of COD
    - Section 382 ownership change/limitation.

34

Qualified Real Property Indebtedness

35

Qualified real property business indebtedness – IRC §108(c)

- Qualified real property business indebtedness (QRPBI) is indebtedness that satisfies the following requirements:
  - The indebtedness is incurred or assumed in connection with real property used in a trade or business, which is secured by such property.
  - The indebtedness is "qualified acquisition indebtedness", or was incurred or assumed before January 1, 1993
    - "Qualified acquisition indebtedness" is debt that is incurred or assumed to acquire, construct, reconstruct or substantially improve real property and is secured by such property.
  - The taxpayer makes an election to utilize the qualified real property business indebtedness exclusion.

36

Amount of QRPBI Excludable

- The amount of discharge of indebtedness income that may be excluded is subject to both a fair market value limitation and an aggregate basis limitation.
  - Fair market value limitation: The amount excluded with respect to the discharge of any QRPBI may not exceed the excess of: (a) the outstanding principal amount of such debt (immediately before the discharge); over (b) the fair market value (immediately before the discharge) of the real property which is used in a trade or business and which secures the debt.
  - Aggregate basis limitation: the amount excluded from gross income may not exceed the aggregate adjusted basis of depreciable real property held by the taxpayer immediately before the discharge.

37

Amount Excludable: Coordination with Sec. 1017

- Basis is the only tax attribute reduced.
- Basis is reduced only in depreciable real property.
  - Section 1245 or 1250 ordinary income recapture rules apply (see special rule in Section 1017(d)).
- Basis is reduced first in the depreciable real property securing the discharged QRPBI.
- The taxpayer must make the election to reduce basis on its timely filed income tax return for the tax year in which the discharge occurs.
  - The election is made on completed Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment*).
- For partnership debt, the election is made at the partner level.
- The partnership must consent to reduce the partner's basis in the partnership property.

38

State Tax Considerations

39

State Tax Considerations

- None of the following 6 populous high tax states decouple from the election provision of Sec. 108(c):
  - CA, GA, IL, MA, NY & PA
- CA provides for automatic conformity to Sec. 108(c) for state income tax purposes and does not allow for a separate state only election. Calif. R&T Code Sec. 24307(f).
- Certain states decouple from Federal depreciation methods and may cause a pre- and post-election Federal vs. state basis difference in the impacted assets.

40

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41

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Brianne deSellier, CPA is a partner in Crowe LLP's Washington National Tax Office in Miami, and has a deep specialization in M&A, debt restructuring and Subchapter C/consolidated return regulations. She is admitted to the Florida Bar and provides regular industry thought leadership through speaking at conferences, publishing articles, and participating in the drafting of comment letters involving corporate/consolidated tax issues. Ms. deSellier is an active member of the American Bar Association's Tax Section and currently sits on the AICPA's Corporations and Shareholders Technical Resource Panel. She has also appeared as a network TV legal and business analyst with her commentary featured on major networks including CNN, HLN, ITV, "ABC World News" and "Good Morning America." Ms. deSelliers received her Bachelor's degree in accounting from the University of Miami, her J.D. from St. Thomas University in Miami and her LL.M. in taxation from New York University. She graduated in the top 1% of her law school class (*summa cum laude*) and was named salutatorian of her graduating class.

Kevin M. Jacobs, CPA is a managing director with Alvarez & Marsal Taxand in Washington, D.C., and is the National Tax Office Practice leader. He brings more than 15 years of experience in tax matters in both the public and the private sectors. Prior to joining A&M, Mr. Jacobs was a senior technician reviewer (TCJA) with the IRS Office of Associate Chief Counsel (Corporate) for more than six years, where he advised on tax issues such as tax attributes (earning and profits, recovery and allocation of stock basis, and Section 108(b) attribute reduction), bankruptcies, corporate reorganizations and corporation-shareholder issues, liquidations, redemptions, spin-offs and consolidated returns. He was the principal Associate Chief Counsel (Corporate) attorney on several regulatory projects, including the proposed Section 382(h) regulations on built-in gains and losses and debt-equity regulations. Mr. Jacobs provided substantial contributions to numerous other guidance projects, such as the limitation on interest deductions regulations, and assisted in overseeing the Corporate Division's response to TCJA, including the coordination with Treasury's Offices of Tax Legislative Counsel and International Tax Counsel. Prior to working at the government, he advised troubled companies and companies in bankruptcy on a wide range of topics including debt workouts and tax-attribute limitations and preservation, as well as other companies on evaluating and purchasing bankruptcy claims. Mr. Jacobs is admitted to the District of Columbia and Florida Bars and is a member of numerous organizations, including the American Bar Association and the New York State Bar Association. He is also a frequent speaker on several attribute-related and corporate transaction tax matters and was the principal drafter of the ABA comments concerning Notice 2010-50 (the implications of fluctuations in value in determining whether there was an ownership change under Section 382). Mr. Jacobs received his Bachelor's degree in accounting, his Master's degree in accounting (with a concentration in taxation) and his J.D. *magna cum laude* from the University of Florida, and his LL.M. in taxation from New York University.

Brian Newman is a partner in CohnReznick LLP's Hartford, Conn., office and practice leader of the firm's Federal Tax Services nationally. He has more than 30 years of experience and concentrates on the formation, operation and dissolution of partnerships, C-corporations, S-corporations and limited liability companies. He also has experience dealing with tax issues for family-owned and Fortune 500 businesses, serving clients across various industries including real estate, manufacturing and

distribution, technology and construction. Mr. Newman is a member of CohnReznick's Performance Improvement practice, where he helps the firm increase collaboration across service lines and create new services to help clients drive growth. He is a frequent speaker and author on issues involving federal and state taxation and partnership taxation matters, and he was appointed an adjunct professor for the University of Hartford's M.S. in Taxation program. Mr. Newman is a frequent speaker and author on issues involving federal and state taxation and partnership taxation matters. As a past trustee of the Connecticut Society of Certified Public Accountants' Educational Trust Fund, he is actively involved in the Greater Hartford community. Mr. Newman received his B.S. from Central Connecticut State University.

Anthony V. Sexton is a tax partner in Kirkland & Ellis LLP's Chicago office, where he focuses his practice on representing debtors, creditors and potential investors in connection with all aspects of in- and out-of-court restructuring transactions, special situations and financings (including liability-management transactions), the interpretation and application of tax-sharing agreements, and other complex structuring issues. He has been tax counsel in many of the largest and most complex restructurings in recent years. Mr. Sexton has obtained several novel private-letter rulings from the Internal Revenue Service to optimize the tax outcomes for his restructuring clients, has been listed as a "Bankruptcy Tax Specialist in the Nation's Major Law Firms" by *Turnarounds & Workouts* since 2018, and was listed as a leading lawyer and "noted for his tax work as it relates to bankruptcies and restructurings" in the 2022 edition of *Chambers USA*. He frequently speaks at conferences, writes articles, and participates in the drafting of comment letters regarding the tax matters that are relevant to distressed companies. Mr. Sexton is currently a member of the Committee on Government Submissions of the ABA Tax Section, with responsibility for submissions made by the Corporate; Affiliated and Related Corporations; and Tax Collection, Bankruptcy and Workouts Committees. He is an editor of a chapter in *Colliers on Bankruptcy Taxation*, is a member of the planning committee for the University of Chicago Federal Tax Conference, teaches courses on the taxation of bankrupt companies and general business planning at the University of Chicago Law School, and is a member of the Board of Trustees of the Taxpayers' Federation of Illinois. He previously was chair of the Affiliated and Related Corporations Committee of the ABA Tax Section from 2021–22. Mr. Sexton received his B.F.A. in music education with high honors in 2007 from the University of Wisconsin-Milwaukee and his J.D. in 2011 from he University of Chicago Law School, where he was the sole recipient of highest honors in his class.