

**2010 USC Tax Institute:**

**Failing and Failed Businesses –  
Considerations under Sections 108 and 382**

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# Topics

## Section 108\* Topics

- ➔ • Section 108(b)(5) Election
- Section 108(i)
- Section 108(e)(4)
- Section 108 & Consolidated Groups

## Section 382 Topics

- NUBIG/RBIG and NUBIL/RBIL Rules
- Section 382(l)(5)
- Section 382(l)(6)

\* Section references are to the Internal Revenue Code of 1986, as amended.

# Section 108

- In general, when a debtor is discharged of an obligation to repay a debt for consideration less than the amount of the obligation, the debtor recognizes cancellation of indebtedness income (“CODI”).
- Section 108(a) provides various exceptions from the inclusion of CODI in taxable income.
- Section 108(b) provides rules to reduce certain tax attributes of debtors whose CODI qualifies for certain Section 108(a) exceptions.
- Section 108(e) provides additional rules and exceptions regarding CODI.
- Section 108(i) sets forth a newly established deferral regime for CODI realized in certain transactions occurring in 2009 and 2010.
- Additional considerations apply to CODI within partnerships and consolidated groups.

# Section 108(b)(5) Election

- To the extent CODI is excluded from gross income under the bankruptcy or insolvency exceptions of Section 108(a), the debtor's tax attributes generally are reduced as follows:

Tax Attribute	Attribute Reduction: \$ of Excluded CODI
NOLs	1:1
Section 38 general business credits	0.333:1
Section 53(b) minimum tax credits	0.333:1
Capital loss carryovers	1:1
Reduction of tax basis in property	1:1
Section 469(b) passive activity loss/credit carryovers	0.333:1
Section 27 foreign tax credit carryovers	0.333:1

- The total amount of tax basis reduction generally is limited to the amount by which the aggregate adjusted bases of the debtor's property immediately after the debt discharge exceeds the aggregate of the debtor's liabilities immediately after the debt discharge.

# Section 108(b)(5) Election

- Instead of the attribute reduction scheme described above, the debtor may elect to apply any portion of excluded CODI to reduce the basis of the debtor's depreciable property under Section 1017, up to the aggregate adjusted bases of the debtor's depreciable property as of the beginning of the taxable year following the year the debt discharge occurs.
- If the debtor makes this election, tax basis reduction will not be limited by the excess of the aggregate bases of the debtor's property over its remaining liabilities.
- If the debtor makes this election, no other tax attributes will be reduced.
- Depending on the specific facts, this election may be useful if the debtor has NOLs that will expire soon and a large amount of basis in long-lived depreciable assets.

# Section 108(b)(5) Election

- Under Section 1017, the term “depreciable property” includes:
  - Property subject to the allowance for depreciation, but only if a basis reduction would reduce the amount of depreciation or amortization otherwise allowable for the period following the reduction;
  - Interests in a partnership to the extent the partnership reduces its basis in the partner’s proportionate share of the partnership’s depreciable property;
  - Stock of subsidiaries in an affiliated group to the extent the subsidiary makes a corresponding reduction in the basis of its depreciable property; and
  - Real property held for sale to customers in the ordinary course of business.

# Topics

## Section 108 Topics

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# Section 108(i)

- Section 108(i) was added into law by the American Recovery and Reinvestment Act of 2009.
- Four Main Components of Section 108(i):
  - Defer CODI in the case of CODI triggered upon the “reacquisition” of an “applicable debt instrument” (“ADI”) and include that CODI ratably over a 5-year period, generally beginning in 2014.
  - Defer all or a portion of any original issue discount (“OID”) arising on any newly issued debt instrument if CODI deferral is elected and if (i) the new debt instrument was issued (or deemed issued) in exchange for an ADI or (ii) the proceeds of the new debt instrument were used to effect the reacquisition of an ADI.
  - Accelerate deferred CODI and deferred OID deductions upon certain events.
  - For partnerships, (i) allocate CODI when recognized in the manner it would have been allocated if it had not been deferred and (ii) reduce the deemed distribution under Section 752(b) resulting from the reacquisition to the extent that the deemed distribution would give rise to gain under Section 731.



# Section 108(i) – CODI Deferral

- At the debtor's election, CODI in connection with the "reacquisition" of an ADI after December 31, 2008 and before January 1, 2011 is included in gross income ratably over the five-taxable-year-period (the "Recognition Period") generally beginning in 2014.
- The Section 108(i) election may be made with respect to all or only a portion of the CODI recognized upon the reacquisition of an ADI during the Recognition Period.
- A protective election may be made by a debtor who concludes a particular reacquisition didn't trigger CODI.
- Section 108(a) does not apply to any CODI deferred as a result of a Section 108(i) election.

# Section 108(i) – CODI Deferral

- Applicable Debt Instrument – any debt instrument issued by a C corporation or any other person in connection with the conduct of a trade or business.
- Reacquisition – any acquisition of an ADI by the debtor that issued (or is otherwise the obligor under) the debt instrument or a related person. For these purposes, an acquisition includes:
  - An acquisition of the ADI for cash;
  - The exchange of the ADI for another debt instrument;
  - A deemed exchange pursuant to a modification of the ADI;
  - The exchange of an ADI for corporate stock or partnership interests;
  - The contribution of the ADI to the debtor’s capital; and
  - The complete forgiveness of the ADI by the holder.

# Section 108(i) – OID Deferral

- If a debt instrument is issued for the ADI being reacquired and there is OID with respect to the newly issued debt instrument, no OID deduction “otherwise allowable” is allowed to the debtor that issues such debt instrument with respect to the portion of such OID which:
  - accrues before the Recognition Period; and
  - does not exceed the CODI with respect to the ADI reacquired.
- The disallowed OID deductions may be deducted ratably over the Recognition Period (*i.e.*, when the deferred CODI is recognized).
- If a debtor uses the proceeds from the issuance of a debt instrument to reacquire directly or indirectly an ADI of the debtor, the debt instrument so issued is treated as issued for the reacquired ADI.
- If only a portion of the proceeds from the debt instrument is so used, the OID deferral applies only to the portion of any OID on the new debt instrument which is equal to the portion of the proceeds used to reacquire the ADI.

# Section 108(i) – Acceleration Events

- The liquidation or sale of substantially all of the assets of a debtor that makes a Section 108(i) election will result in the acceleration of amounts deferred under Section 108(i).
- Acceleration of deferred CODI (and related OID deductions) also occurs in the case of the sale, exchange or redemption of an interest in a partnership, S corporation or other pass-through entity by a partner or shareholder of such entity.

# Section 108(i) – Partnership Rules

- In the case of a partnership, any deferred CODI must be allocated to the partners immediately before the discharge in the manner such amounts would have been included in such partners' distributive shares if the CODI were recognized at such time.
- Any decrease in a partner's share of partnership liabilities as a result of the discharge is not taken into account for purposes of Section 752 at the time of the discharge to the extent it would cause the partner to recognize gain under Section 731.
  - The decrease is taken into account by each relevant partner at the same time, and to the extent remaining in the same amount, as deferred CODI is recognized under Section 108(i).

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# Section 108(e)(4)

- Background
  - CODI is triggered when a debtor's indebtedness is forgiven or repurchased by the debtor at a discount.
  - Under Section 108(e)(4), CODI is also triggered when certain entities acquire debt of a related debtor at a discount from an unrelated party.
- Indirect Acquisitions
  - If an unrelated acquiror of debt acquired such debt in anticipation of becoming related to the debtor, that acquisition will fall within the scope of these rules.
  - Generally a facts-and-circumstances test is used to determine if an unrelated acquiror acquires debt in anticipation of becoming related to the debtor.
  - If the acquiror becomes related to the debtor within six months of acquiring the debtor's debt, the acquiror will be treated as related to the debtor.

# Section 108(e)(4) – Related Parties

- An individual is treated as related to a corporation more than 50% owned, directly or indirectly, by or for such individual.
- A corporation and partnership are related if the same person owns more than 50% of both entities.
- Two corporations are related if they are members of the same “controlled group” – *i.e.*, one or more chains of corporations connected through stock ownership with a common parent corporation if:
  - Stock possessing at least 50% of the total vote or value is owned by one or more of the other corporations, and the common parent owns stock possessing at least 50% of the total vote or value of at least one of the other corporations in the chain; or
  - Two or more corporations, if five or fewer persons who are individuals, estates, or trusts own stock possessing more than 50% of the total combined vote or value of each corporation.
- Two entities are related if they are treated as a single employer under Sections 414(b) or (c).



# Section 108(e)(4) – Constructive Ownership

- Shareholders of a corporation and partners of a partnership are treated as owning stock owned by the corporation or partnership, respectively.
- An individual is treated as owning stock owned by the individual's spouse, children, grandchildren, parents, and any spouse of the individual's children or grandchildren.
- A partner is treated as owning stock owned by other partners.
- Special rules
  - Stock constructively owned by an individual under the first bullet-point above is treated as actually owned by that individual for purposes of applying each of the constructive ownership rules above.
  - Stock constructively owned by an individual under the second or third bullet-point above is not treated as actually owned by that individual for purposes of again applying these rules to another person.

## Section 108(e)(4) – Exceptions

- No CODI results from the direct or indirect acquisition of indebtedness by a related party if the debt has a stated maturity date that is not more than one year after the date of the debt's acquisition, but only if the debt is actually retired on or before its stated maturity date.
- No CODI results from the direct or indirect acquisition of indebtedness by a related party that is a dealer that acquires and disposes of debt in the ordinary course of business and certain other requirements are met.

# Section 108(e)(4) – Mechanics

## Amount of CODI

- In general, the amount of CODI is measured by the related acquiror's adjusted basis in the debt purchased (*i.e.*, the purchase price).
- If, however, the holder did not acquire the debt by purchase on or less than 6 months before the “acquisition date” (generally the date on which the holder becomes related to the debtor), then the amount of CODI will be measured by the fair market value of the debt on the acquisition date.

## Correlative Adjustments

- If the debtor recognizes CODI upon the acquisition of debt by a related party, the debt is treated as new debt issued by the debtor to the related acquiror on the acquisition date at an issue price equal to the acquiror's adjusted basis or the fair market value of the debt, as applicable.
- If the stated redemption price at maturity exceeds the issue price, the new debt will be treated as issued with OID.
- If the related acquiror issued its own debt in exchange for the debt it acquired and the issue price of the debt issued by the acquiror is not determined by reference to its fair market value (*e.g.*, the debt is treated as issued at its stated redemption price at maturity under Section 1273(b)(4)), then the acquiror must defer recognition of any loss (or other comparable tax benefit) on the subsequent disposition of the acquired debt until the debtor retires the debt.

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# Section 108 & Consolidated Groups

- Whether CODI recognized by a debtor-member of a consolidated group is excluded under Section 108(a) is determined on a member-by-member basis (*i.e.*, based only on the bankruptcy status or the assets and liabilities of the debtor-member that realizes the CODI).
- If CODI of the debtor-member is excluded under Section 108(a), the tax attributes attributable to the debtor-member (and its direct and indirect subsidiaries) are reduced under Section 108(b) before the attributes of other members of the consolidated group are reduced.
- Special ordering rules apply if there are multiple debtor-members, if a debtor-member leaves the group or if there is an intergroup reorganization.

# Section 108 & Consolidated Groups – Look-Through Rules

- If the debtor-member elects to treat the stock of its subsidiaries as depreciable property pursuant to Section 108(b)(5), the basis of the depreciable property of such subsidiaries is reduced before the following subsidiary look-through rules apply.
  - For purposes of applying the rules of Section 108(b)(5), the basis of stock of a lower-tier member that has an excess loss account is treated as zero.
- A special look-through rule applies if the debtor-member is required to reduce the basis of a lower-tier member's stock and the lower-tier member and debtor-member are part of the same consolidated group on:
  - the last day of the debtor-member's taxable year that includes the date on which the debtor-member realized the excluded CODI, or
  - the first day of the following taxable year.
- Under this rule, the lower-tier member is treated as realizing CODI on the last day of the taxable year of the debtor-member that includes the date on which the debtor-member realized the excluded CODI.
- The lower-tier member must reduce its tax attributes as provided in Sections 108 and 1017 (as adjusted by Treas. Reg. Section 1.1502-28).
- If the deemed CODI of the lower-tier member exceeds the lower-tier member's tax attributes, such CODI is **not** applied to reduce the tax attributes of any other member of the consolidated group (*i.e.*, other members in a different chain) and does **not** cause any excess loss accounts to be triggered.

# Section 108 & Consolidated Groups – Other Members' Attributes

- To the extent the excluded CODI is not applied to reduce the tax attributes attributable to the debtor-member that realizes the excluded CODI, after the application of the look-through rules, such amount shall be applied to reduce:
  - The remaining consolidated tax attributes of the consolidated group, other than such attributes to which a SRLY limitation applies;
  - The tax attributes of a SRLY subgroup of which the debtor-member is a member and to which a SRLY limitation applies with respect to such attributes; and
  - The tax attributes attributable to members that arose in a SRLY if no SRLY limitation applies to the use of such tax attributes.
- The tax attributes are reduced in the order prescribed by Section 108(b)(2), but basis in assets may not be reduced pursuant to this rule.

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# Section 382 – NUBIL/NUBIG

- Section 382 generally limits the amount of income that may be offset by NOLs each year following an ownership change.
  - If the new loss corporation does not continue the business enterprise of the old loss corporation for two years, the Section 382 limitation generally will be zero.
  - Under the American Recovery and Reinvestment Act of 2009, the Section 382 loss limitation rules do not apply to an ownership change pursuant to a restructuring plan (i) required under a loan agreement or a commitment for a line of credit entered into with the Department of the Treasury under the Emergency Economic Stabilization Act of 2008, and (ii) intended to result in a rationalization of the costs, capitalization, and capacity with respect to the manufacturing workforce of, and suppliers to, the debtor and its subsidiaries.
- Special rules apply if the corporation has a net unrealized built-in gain (NUBIG) or net unrealized built-in loss (NUBIL).
  - NUBIG generally equals the excess of the aggregate fair market value of the loss corporation's assets immediately before the ownership change over the aggregate adjusted basis of those assets.
  - NUBIL generally equals the excess of the aggregate adjusted basis of the loss corporation's assets immediately before the ownership change over the aggregate fair market value of those assets.
  - However, NUBIG or NUBIL is treated as \$0 if the amount of NUBIG or NUBIL is not greater than the lesser of (i) 15% of the loss corporation's FMV immediately before the ownership change or (ii) \$10 million.

# Section 382 – RBIG/RBIL

- For a loss corporation with NUBIG, the Section 382 limitation generally is increased by built-in gains that are recognized (“RBIG”) during the 5-year period following the ownership change (the “Recognition Period”).
  - Policy: such gain should not be subject to the Section 382 limitation merely because the gain is recognized after the ownership change since the loss corporation could have used its NOLs without limitation to offset the resulting gain if the relevant assets had been sold before the ownership change.
- For a loss corporation with NUBIL, unrecognized built-in losses that are recognized (“RBIL”) during the Recognition Period are subject to the Section 382 limitations.
  - Policy: such losses should not escape the Section 382 limitation merely because they are recognized after an ownership change since the loss would have been subject to the Section 382 limitation if it had been recognized before the ownership change.

# Section 382 – NUBIG/NUBIL Calculations

- Notice 2003-65 sets forth two alternative methods for calculating NUBIG/RBIG and NUBIL/RBIL.
- According to the Notice, NUBIG or NUBIL is the net amount of gain or loss that would be recognized in a hypothetical sale of the assets of the loss corporation immediately before the ownership change, calculated by determining:
  - the amount realized if immediately before the ownership change the loss corporation sold all of its assets, including goodwill, at fair market value to a third party that assumed all of its liabilities;
  - MINUS the sum of any deductible liabilities of the loss corporation that would be included in the amount realized on the hypothetical sale and the loss corporation's aggregate adjusted basis in all of its assets;
  - PLUS or MINUS the corporation's Section 481 adjustments that would be taken into account on a hypothetical sale;
  - PLUS any RBIL that would not be allowed as a deduction under Sections 382, 383, or 384 following the hypothetical sale.
- The amount by which this result exceeds \$0 is the loss corporation's NUBIG.
- The amount by which \$0 exceeds this result is the loss corporation's NUBIL.
- NOTE: This calculation is the same under either alternative method of calculating RBIG and RBIL discussed below.

# Section 382 – RBIG/RBIL – Section 1374

## Approach

- The Section 1374 approach generally incorporates the rules of Section 1374(d) in identifying RBIG and RBIL.

### Sales or Exchanges of Assets

- Gain or loss recognized during the recognition period on the sale or exchange of an asset generally is RBIG or RBIL.

### Other Items of Income and Deduction

- The Section 1374 approach generally relies on the accrual method of accounting to identify income or deduction items as RBIG or RBIL, respectively.
- Items of income or deduction properly included in income or allowed as a deduction during the recognition period are treated as RBIG or RBIL, respectively, if an accrual method taxpayer would have included the item in income or been allowed a deduction for the item before the ownership change date.

### Income from Built-in Gain Assets

- In general, the Section 1374 approach does not treat income from a built-in gain asset during the recognition period as RBIG because such income did not accrue before the change date.

# Section 382 – RBIG/RBIL – Section 1374 Approach

## Depreciation Deductions on Built-in Loss Assets

- Except to the extent the loss corporation establishes that the amount is not attributable to the excess of an asset's adjusted basis over its fair market value on the ownership change date, depreciation, amortization and depletion deductions are treated as RBIL, regardless of whether they accrued for tax purposes before the ownership change date.
- This approach differs from the tax accrual rules and the Section 1374 regulations.

## CODI

- CODI or bad debt deductions under Section 166 generally treated as RBIG or RBIL if properly taken into account during the first 12 months of the recognition period if the item arises from a debt owed by or to the loss corporation at the beginning of the recognition period.
- Any resulting reduction of tax basis under Sections 108(b)(5) and 1017(a) is treated as having occurred immediately before the ownership change, but only for purposes of determining whether a recognized gain or loss is an RBIG or an RBIL.
- The reduction of tax basis does not affect the loss corporation's NUBIG or NUBIL.

# Section 382 – RBIG/RBIL – Section 338 Approach

## Introduction

- The Section 338 approach identifies items of RBIG and RBIL generally by comparing the loss corporation's actual items of income, gain, deduction, and loss with those that would have resulted if a Section 338 election had been made with respect to a hypothetical purchase of all of the outstanding stock of the loss corporation on the ownership change date (the "Hypothetical Purchase").
- Unlike the Section 1374 approach, the Section 338 approach provides that built-in gain assets may be treated as generating RBIG even if they are not disposed of at a gain during the recognition period, and deductions for liabilities, in particular contingent liabilities, that exist on the change date may be treated as RBIL.
- This means that for contingent liabilities, the Section 338 approach treats a deduction for the payment of a liability that is contingent on the change date as RBIL to the extent of the estimated liability on the change date.

# Section 382 – RBIG/RBIL – Section 338 Approach

## Sales or Exchanges of Assets

- The Section 338 approach identifies RBIG or RBIL from sales and exchanges of assets by comparing the loss corporation's actual items of gain or loss with the gain or loss that would result if a Section 338 election had been made for the Hypothetical Purchase.

## Depreciation/Amortization of Built-in Gain Assets

- The Section 338 approach treats as RBIG an amount equal to the excess of the cost recovery deduction that would have been allowable with respect to any built-in gain asset if a Section 338 election had been made for the Hypothetical Purchase over the loss corporation's actual allowable cost recovery deduction.
- The excess is treated as RBIG regardless of the loss corporation's income for the year.

# Section 382 – RBIG/RBIL – Section 338 Approach

## Depreciation and Amortization of Built-in-Loss Assets

- For loss corporations with a NUBIL, the Section 338 approach treats as RBIL the excess of the loss corporation's actual allowable cost recovery deduction over the cost recovery deduction that would have been allowable to the loss corporation with respect to any built-in-loss asset had a Section 338 election been made with respect to the Hypothetical Purchase.

## CODI

- Under the Section 338 approach, CODI attributable to any pre-ownership change debt of the loss corporation is RBIG in an amount not exceeding the excess, if any, of the adjusted issue price of the discharged debt over the fair market value of the debt on the ownership change date.
- The Section 338 approach treats a reduction of tax basis under Sections 108(b)(5) and 1017(a) that occurs during the recognition period as having occurred immediately before the ownership change for purposes of Section 382(h)(2) to the extent of the excess, if any, of the adjusted issue price of the debt over the fair market value of the debt on the change date.
- The reduction of tax basis does not affect the loss corporation's NUBIG or NUBIL.



# Topics

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- Section 108(b)(5) Election
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- Section 382(l)(6)

# Section 382(I)(5) – Introduction

- Section 382(I)(5) - the Section 382 limitation shall not apply to any ownership change if:
  - the loss corporation is (immediately before such ownership change) under the jurisdiction of the court in a title 11 or similar case (a receivership, foreclosure, or similar proceeding in a Federal or state court);
  - the transaction resulting in the ownership change is ordered by the court or is pursuant to a plan approved by the court; and
  - the shareholders and “old and cold” creditors of the loss corporation (determined immediately before such ownership change) own (after such ownership change and as a result of being shareholders or creditors immediately before such change) 50% or more of the vote and value of the stock of the new loss corporation (or stock of a controlling corporation if also in bankruptcy).

# Section 382(l)(5) – Introduction

## “Old and cold” creditors

- Subject to certain exceptions (including an exception for less than 5% holders of publicly traded debt), these are the beneficial owners (determined without applying attribution rules), immediately before the ownership change, of “qualified indebtedness” of the loss corporation.
- Such a creditor is treated as owning stock of the new loss corporation (or a controlling corporation) only to the extent it receives stock in full or partial satisfaction of qualified indebtedness (in a transaction that is ordered by the court or is pursuant to a court approved plan).

## Qualified Indebtedness

- Indebtedness of the loss corporation that:
  - was owned by the same beneficial owner for 18 months prior to the filing of the title 11 or similar case; or
  - arose in the ordinary course of the trade or business of the loss corporation and has been owned at all times by the same beneficial owner.

# Section 382(l)(5) – Introduction

## Qualifying Indebtedness (Cont.)

- A loss corporation may treat indebtedness as always having been owned by the beneficial owner of the indebtedness immediately before the ownership change (*i.e.*, qualified indebtedness if outstanding for 18 months prior to filing or arising in the ordinary course of business) if the beneficial owner is not, immediately after the ownership change, either a 5% shareholder or an entity through which a 5% shareholder owns an indirect ownership interest in the loss corporation.
- In addition to a number of other operating rules, the 5% shareholder rule does not apply to indebtedness beneficially owned by a person whose participation in formulating a plan of reorganization makes evident to the loss corporation (whether or not the loss corporation had previous knowledge) that the person has not owned the indebtedness for the requisite period.
  - Also, if the loss corporation has actual knowledge of coordinated acquisitions of its debt by multiple persons for a principal purpose of exchanging the debt for the loss corporation's stock, that coordinated group will be treated as a single entity holding all of the loss corporation's debt (and resulting stock).
- For indebtedness where this 5% shareholder rule does not apply, the loss corporation has a duty of inquiry to determine that the debt has been owned at all times during the requisite period.

# Section 382(l)(5) – Mechanics

- If Section 382(l)(5) applies, the new loss corporation is not subject to a Section 382 limitation on its use of NOLs.
  - However, as discussed above, in title 11 and insolvency situations, Section 108(b) requires the borrower to reduce its tax attributes by the amount excluded from CODI, typically beginning with NOLs.
  - Also, as discussed above, the taxpayer may instead elect to first reduce the basis of its depreciable property under Section 108(b)(5).
- NOLs are recalculated as if no deduction were allowable for interest paid or accrued on debt which was converted into stock pursuant to the bankruptcy reorganization during the current and the three preceding tax years (typically referred to as the “Section 382(l)(5) toll charge”).

# Section 382(l)(5) – Mechanics

## Section 269 Business Continuity Requirement

- Under the general Section 382 rules, if the corporation does not continue the pre-ownership change business enterprise of the loss corporation, the Section 382 limitation will be zero.
- However, this continuity of business requirement is not applicable under Section 382(l)(5), and instead, the Section 269 rules apply.
- Under Section 269, absent strong evidence to the contrary, a Section 382(l)(5) ownership change is deemed made for the principal purpose of evasion or avoidance of income tax (and the losses are thus disallowed), unless the corporation carries on more than an insignificant amount of an active trade or business during and after the bankruptcy case.
- Bankruptcy plan confirmation orders should provide a statement that the court has determined that the principal purpose of the plan is not the avoidance of taxes.

## Section 382(l)(5) – Second Ownership Changes

- If Section 382(l)(5) applies and there is a second ownership change within two years, the Section 382 limitation will be zero.
- One increasingly common strategy to avoid triggering a second ownership change within this two-year period is to include appropriate transfer restrictions in the reorganized debtor's new charter and bylaws and include a notation on each of the equity certificates.

## Sample Charter Restriction on Transfer: WXH Corporation

- “Any attempted Transfer of Corporation Securities prior to the Restriction Release Date, or any attempted Transfer of Corporation Securities pursuant to an agreement entered into prior to the Restriction Release Date, will be prohibited and *void ab initio* if either (A) the transferor is a Five-Percent Stockholder [pursuant to applicable Treasury Regulations] or (B) as a result of such Transfer, either (1) any Person or group of Persons would become a Five-Percent Stockholder or (2) the Percentage Stock Ownership in the Corporation of any Five-Percent Stockholder would be increased” subject to certain exceptions and limitations. (Amended and Restated Certificate of Incorporation of WHC Corporation)
- Board of directors may waive these restrictions.
- Shares that would, if transferred, violate these restrictions are required to be transferred to a specified agent for prompt sale to a buyer in compliance with the charter restrictions.




## Sample Charter Restriction on Transfer: Winn-Dixie Stores

- Subject to certain exceptions and limitations, any transfer during the “Restriction Period” that results in the increase in the “Percentage Stock Ownership of Common Stock by a 5-Percent Stockholder” (as defined in applicable Treasury Regulations) over the lowest Percentage Stock Ownership of Common Stock by such 5-Percent Stockholder at any time since the “Effective Time” shall be null and void *ab initio* and shall not be effective to transfer Common Stock, but only to the minimum extent necessary to prevent the transfer from having such result. (Amended and Restated Certificate of Incorporation of Winn-Dixie Stores, Inc.)
- Board of directors may waive these restrictions.
- Shares that would, if transferred, violate these restrictions are required to be transferred to a specified agent for prompt sale to a buyer in compliance with the charter restrictions.

## Section 108 Topics

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- If Section 382(l)(5) does not apply to an ownership change triggered by a bankruptcy reorganization (or its treatment is revoked by the debtor), the Section 382 limitation will be calculated under Section 382(l)(6).

### Section 382(l)(6)

- Subject to various rules and exceptions, the value of the loss corporation is the lesser of:
  - The stock value of the loss corporation immediately after the ownership change (calculated to reflect any increase in value resulting from any surrender or cancellation of creditors' claims in the transaction); or
  - The value of the loss corporation's pre-ownership change assets (determined without regard to liabilities).
- The general Section 382 continuity of business requirement is applicable (a violation sets the Section 382 limitation to zero).
- If there is a second ownership change within two years, a Section 382 limitation will apply (*i.e.*, the Section 382(l)(5) rule setting the Section 382 limitation to zero will not apply).

- For purposes of measuring the value of the loss corporation, any capital contribution received by an old loss corporation as part of a plan a principal purpose of which is to avoid or increase the Section 382 limitation is not to be taken into account (*i.e.*, attempts to inflate the value of the loss corporation by pre-ownership change contributions will be disregarded).
- While the Code provides that any capital contribution made during the 2-year period ending on the ownership change date shall be treated as made as part of a plan to increase the Section 382 limitation, the IRS has provided safe-harbor exceptions from this rule.
- One such exception applies if:
  - the contribution is made by a person who is neither a controlling shareholder under Treasury Regulations Section 1.355-7 (determined immediately before the contribution) nor a related party (under Section 267(b));
  - no more than 20% of the total value of the loss corporation's outstanding stock is issued in connection with the contribution;
  - there was no agreement, understanding, arrangement, or substantial negotiations at the time of the contribution regarding a transaction that would result in an ownership change; and
  - the ownership change occurs more than six months after the contribution.

- Another such exception applies if:
  - the contribution is made by a related party but no more than 10% of the total value of the loss corporation's stock is issued in connection with the contribution or the contribution is made by a person other than a related party;
  - in either case, there was no agreement, understanding, arrangement, or substantial negotiations at the time of the contribution regarding a transaction that would result in an ownership change; and
  - the ownership change occurs more than one year after the contribution.
- Exceptions also apply to stock issued in connection with the performance of services and contributions made during the formation of the loss corporation or before the first year from which there is a carryforward of an NOL, capital loss, excess credit, or excess foreign taxes (or in which a net unrealized built-in loss arose).
- The above exceptions are provided in IRS Notice 2008-78 and apply to capital contributions occurring in any taxable year ending after September 25, 2008 until further guidance is provided.
- Pursuant to IRS Notice 2009-14, capital contributions by the US Treasury pursuant to the TARP are also not subject to these anti-stuffing rules.