Taxation of Bankruptcies

1) Defining COD income
   a) There must have been an actual benefit conveyed at the beginning with a real obligation to pay, so in forgiving it there must be an actual accession to wealth at the end
      i) things where there are no cash received at the beginning
         (1) tort liability (ironically)
         (2) Guarantees
            (a) Guarantors received no loan proceeds, then they have no COD income upon when the guarantee is released
            (b) And, of course, this would mean that guarantors have COD every time the debtor pays any bit of the outstanding loan
         (3) Release of guarantee in exchange for money (might be done to take a bad debt deduction under § 166) is treated as if the guarantor becomes the holder of the debt and can take a deduction (but if the deduction is immediate, he can only realize a STCL)
            (a) *Putnam*: if a guarantor pays to be let off the hook, he is subrogated and he might have bad debt, and the guarantor can taken an immediate loss (but since § 166 only looks to **business** bad debt, only non-business will count)
            (b) Can waive right of subrogation and can take ordinary loss[1] provided they do it before default
         (4) Dividends in the form of binds
            (a) Rail Joint
   b) Repurchased debt
      i) Kirby Lumber: corporation bought it own bonds for less than they were issued out, thereby effectively canceling some of the debt[2] they now have more money available to them
         (1) (Freeing of assets: increase in assets if the taxpayer now how assets that would have gone to paying debt)
         (2) purchases of debt by a related party
            (a) if a party that is related to a debtor purchases a debt from an unrelated creditor for less than the value it COD[3] (definitions of related parties)
               (i) direct acquisition (where sub buys debt from 3d party)

[1] Putnam
[2] Kirby Lumber
[3] 108(e)(4): Acquisition of indebtedness by person related to debtor.--
(A) Treated as acquisition by debtor.--For purposes of determining income of the debtor from discharge of indebtedness, to the extent provided in regulations prescribed by the Secretary, the acquisition of outstanding indebtedness by a person bearing a relationship to the debtor specified in section 267(b) or 707(b)(1) from a person who does not bear such a relationship to the debtor shall be treated as the acquisition of such indebtedness by the debtor. Such regulations shall provide for such adjustments in the treatment of any subsequent transactions involving the indebtedness as may be appropriate by reason of the application of the preceding sentence.
(B) Members of family.--For purposes of this paragraph, sections 267(b) and 707(b)(1) shall be applied as if section 267(c)(4) provided that the family of an individual consists of the individual's **spouse, the individual's children, grandchildren, and parents, and any spouse of the individual's children or grandchildren.**
(C) Entities under common control treated as related.--For purposes of this paragraph, two entities which are treated as a single employer under subsection (b) or (c) of section 414 shall be treated as bearing a relationship to each other which is described in section 267(b).

1. debtor is deemed to have issued a new debt to the sub with a price equal to what is used to pay the debt
2. OID to parent (correlative adjustments)[4]
3. income to sub
4. if the obligation is actually paid back, the books balance

(ii) indirect acquisition (when they become related later on)

1. requirements that
2. timeframes for reporting requirements – if no disclosure, presumed to intending to acquire directly.
   a. Calculating holding period
      i. suspended if the holder is protected -- either directly or indirectly -- against risk of loss loss by an option, a short sale, or any other device or transaction.[5]
      ii. Tacking may be used in determining the 6-to-24 month period. [6]
   b. under 6 months: **assumed** to have acquired the sub for the purpose of acquiring in the future
   c. 6-24 months: must report if debt is 25% or more of the gross assets of the holder group[7]

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[4] 1.108-2(g) Correlative adjustments—

(1) Deemed issuance. For income tax purposes, if a debtor realizes income from discharge of its indebtedness in a **direct or an indirect** acquisition under this section (whether or not the income is excludible under section 108(a)), the debtor's indebtedness is treated as new indebtedness issued by the debtor to the related holder on the acquisition date (the deemed issuance). The new indebtedness is deemed issued with an issue price equal to the amount used under paragraph (f) of this section to compute the amount realized by the debtor under paragraph (a) of this section (i.e., either the holder's adjusted basis or the fair market value of the indebtedness, as the case may be). Under section 1273(a)(1), the excess of the stated redemption price at maturity (as defined in section 1273(a)(2)) of the indebtedness over its issue price is original issue discount (OID) which, to the extent provided in sections 163 and 1272, is deductible by the debtor and includible in the gross income of the related holder. Notwithstanding the foregoing, the Commissioner may provide by Revenue Procedure or other published guidance that the indebtedness is not treated as newly issued indebtedness for purposes of designated provisions of the income tax laws.

(2) Treatment of related holder. **The related holder does not recognize any gain or loss on the deemed issuance described in paragraph (g)(1) of this section**. The related holder's adjusted basis in the indebtedness remains the same as it was immediately before the deemed issuance. The deemed issuance is treated as a purchase of the indebtedness by the related holder for purposes of section 1272(a)(7) (pertaining to reduction of original issue discount where a subsequent holder pays acquisition premium) and section 1276 (pertaining to acquisitions of debt at a market discount).

(3) Loss deferral on disposition of indebtedness acquired in certain exchanges. (i) **Any loss** otherwise allowable to a related holder on the disposition at any time of indebtedness acquired in a direct or indirect acquisition (whether or not any discharge of indebtedness income was realized under paragraph (a) of this section) is **deferred until the date the debtor retires the indebtedness** if-

(A) The related holder acquired the debtor's indebtedness in exchange for its own indebtedness; and

(B) The issue price of the related holder's indebtedness was not determined by reference to its fair market value (e.g., the issue price was determined under section 1273(b)(4) or 1274(a) or any other provision of applicable law).

(ii) Any comparable tax benefit that would otherwise be available to the holder, debtor, or any person related to either, in any other transaction that directly or indirectly results in the disposition of the indebtedness is also deferred until the date the debtor retires the indebtedness.

[5] 1.108-2(c)(6)(i) loss by an option, a short sale, or any other device or transaction.

[6] 1.108-2(c)(6)(ii) For purposes of paragraphs (c)(3) and (c)(4)(iii) of this section, the period for which a holder held the debtor's indebtedness includes—

(A) The period for which the indebtedness was held by a corporation to whose attributes the holder succeeded pursuant to section 381; and

(B) The period (ending on the date on which the holder becomes related to the debtor) for which the indebtedness was held continuously by members of the holder group (as defined in paragraph (c)(5) of this section).

[7] 1.108-2(c)(4): Disclosure of potential indirect acquisition-

i) In general. If a holder of outstanding indebtedness becomes related to the debtor under the circumstances described in paragraph (c)(4)(ii) or (iii) of this section, the debtor is required to attach the statement described in paragraph (c)(4)(iv) of this section to its tax return (or to a qualified amended return within the meaning of § 1.6664-2(c)(3)) for the taxable year in which the debtor becomes related to the holder, unless the debtor reports its

i. facts to be analyzed: These include, but are not limited to: (1) the intent of the parties at the time of the acquisition; (2) the nature of any contacts between the parties (or their affiliates) before the acquisition; (3) the period of time that the holder has held the indebtedness; and (4) the significance of the indebtedness in proportion to the total assets of the holder group

d. over 24 months: no need to report unless acquired for the sole purpose of retiring debt

e. no disclosure: presumption of intent

ii) Kerbaugh-Empire: reduction in debt due to declining currency was not COD income, and such a transaction was an overall loss

c) Satisfied for less than the amount of the debt
   i) The initial amount of the debt will be preserved (in calculating amount discharged) if there was a tax-free exchange under § 354.[8]

d) Writing off by a creditor
   i) Just because a bank writes off a debt, it doesn't mean that the debt has actually been written off if debt is sold and later collected on[9]

e) Statute of limitations expiration
   i) Running of statute doesn't necessary mean discharge because the debt may choose to acknowledge a pay the liability.
   ii) Must inquire as to whether or not a bar on enforcement can be waived or not

f) Unenforceable under state law
   i) If the debt is unenforceable, a later payment of the debt in prop becomes two transactions (payment of debt, and realization of value of property)
   ii) If an unenforceable debt is paid, there is no COD, because there is no debt [10]

g) Transfers of property: a transfer of property in satisfaction of debt will be bifurcated[11]

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income on the basis that the holder acquired the indebtedness in anticipation of becoming related to the debtor. Disclosure under this paragraph (c)(4) is in addition to, and is not in substitution for, any disclosure required to be made under section 6662, 6664 or 6694.

(ii) Indebtedness represents more than 25 percent of holder group's assets—

(A) In general. Disclosure under this paragraph (c)(4) is required if, on the date the holder becomes related to the debtor, indebtedness of the debtor represents more than 25 percent of the fair market value of the total gross assets of the holder group (as defined in paragraph (c)(5) of this section).

B) Determination of total gross assets. In determining the total gross assets of the holder group, total gross assets do not include any cash, cash item, marketable stock or security, short-term indebtedness, option, futures contract, notional principal contract, or similar item (other than indebtedness of the debtor), nor do total gross assets include any asset in which the holder has substantially reduced its risk of loss. In addition, total gross assets do not include any ownership interest in or indebtedness of a member of the holder group.

(iii) Indebtedness acquired within 6 to 24 months of becoming related. Disclosure under this paragraph (c)(4) is required if the holder acquired the indebtedness 6 months or more before the date the holder becomes related to the debtor, but less than 24 months before that date.

(iv) Contents of statement. A statement under this paragraph (c)(4) must include the following--

…...

(v) Failure to disclose. In addition to any other penalties that may apply, if a debtor fails to provide a statement required by this paragraph (c)(4), the **holder is presumed to have acquired the indebtedness in anticipation of becoming related to the debtor unless the facts and circumstances clearly established that the holder did not acquire the indebtedness in anticipation of becoming related to the debtor**

[8] US Steel
[9] Long v. Turner (5th Cir, applying Texas law)
[10] Hall
[11] Hall

h) Agreements to cancel debt in the future that are contingent on future events are not COD
   i) Setting one debt off against another, will result in COD to both parties[12] (setoff)
   ii) If the debtor is totally in control of the conditions by which the debt is discharged COD has occurred[13] (court also can look to whether there really was a gain)

i) Reduction in amount of debt to due currency devaluation is not COD income because it didn't result from someone's efforts (old definition of income).[14]

j) Guarantor issues

k) Payment of Dividends via bonds: because dividends are not debt (nor would dividends in the form of bonds be considered to be debt), a reduction (though buying the bonds back) the amount owed would not be COD income because **the bonds were not initially sold, nor did they receive anything of value when the bonds were issued** [15]
   i) If the bonds were issued in exchange for preferred stock, and later satisfied at a bargain (over the stated issued price a.k.a. par value), there is no COD[16] because there was initially no obligation
   ii) If the bonds were issued as a dividend, there is no COD because there was initially no obligation

l) 354 exchanges: The initial amount of the debt will be preserved (in calculating amount discharged) if there was a tax-free exchange under § 354.[17]

2) Calculation of size of debt issue (important thing is to focus on the **issue price**, not the amount of assets that are freed up)
   a) Calculating issue price: must take into account OID[18] because true amount of the debt might be distorted by end-loading amounts due
   b) 354 exchanges: The initial amount of the debt will be preserved (in calculating amount discharged) if there was a tax-free exchange under § 354.[19]
   c) Determining whether liability is fixed or not
      i) There is not income until the liability is fixed[20]
      ii) If defenses are raised to a note under state law, the liability is not fixed[21]
   d) Gambling chips are not necessarily evidence of debt because they include something to be later determined[22]
   e) Face value of debt is only the size of the debt if it can be negotiated to someone else[23] (so gambling chips don't count), only when there is a final determination of what the debt might be.
   f) Initial debt must be in cash or equivalent in order to calculated amount of forgiveness (e. g. gambling chips)[24]

[12] US v. Ingalls
[13] Jelle
[14] Kerbaugh-Empire
[15] Rail Joint
[16] Fashion Park
[17] US X
[18] 1273 rules
[19] US X
[20] Sobel
[21] Sobel
[22] Zarin
[23] Zarin

i) Gambling chips are not cash equivalent

g) Multiple types of payments
   i) If there are two claims, the service apply the first amount paid to the non-COD (so as not to take advantage of any tax-deferred income)[25]

3) Exceptions to COD
   a) No recognition of COD to a cash method tax payer who, has paid it (and, if paid, would have produced a deduction)[26]
   b) Qualified Real property business indebtedness (form of corporate welfare) – **see partnership rules 10)b)i) below on p. 26**
      i) Property used in business, where fair market value of property is less than debt – if the debt is reduced, there will be no COD (rationale: *encourages people not to dump property* to prevent spiral into chaos)
      ii) Requirements for QRPBI to qualify the COD for the exclusion
         (1) Business real estate
         (2) Taxpayer is not a C-Corporation
         (3) Debt is being reduced to not less than the fair market value of the property
         (4) Doesn't apply to discharge exceptions
         (5) Overall limit can't exceed the total of the taxpayer 's basis in all depreciable business real property [27]
         (6) Can't exceed the excess debt on the property[28] plus any other debt that is secured by that same property (principle amount over indebtedness in excess of value).
      iii) Benefits: No liability floor
      iv) **Anti-abuse Stick:** Exception occurs in the succeed year, but if the property is sold within the fiscal year when the reduction occurs, there will be immediate additional income[29]
   c) Purchase-price adjustments (or reduction in size of debt instrument) being used as a shield
      i) **Non-recourse secured**: under circumstance there is no COD income to a solvent taxpayer if the debt undersecured and the debt is reduced to the fair market value, because ***if the property was foreclosed the debtor would not be able to obtain any more in foreclosure proceedings***

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[24] Zarin

[25] 84-176: The amount owed by the taxpayer that is forgiven by the seller in return for a release of a contract counterclaim is not income from discharge of indebtedness under section 61(a)(12) of the Code and therefore is not subject to exclusion under section 108.

[26] 108(e)(2): **Income not realized to extent of lost deductions.**--No income shall be realized from the discharge of indebtedness to the extent that payment of the liability would have given rise to a deduction.

[27] 108(c)(2)(B): **Overall limitation.**--The amount excluded under subparagraph (D) of subsection (a)(1) shall not exceed the aggregate adjusted bases of depreciable real property (determined after any reductions under subsections (b) and (g)) held by the taxpayer immediately before the discharge (other than depreciable real property acquired in contemplation of such discharge).

[28] 108(c)(2)(A): Indebtedness in excess of value.--The amount excluded under subparagraph (D) of subsection (a)(1) with respect to any qualified real property business indebtedness shall not exceed the excess (if any) of--
(i) the outstanding principal amount of such indebtedness (immediately before the discharge), over
(ii) the fair market value of the real property described in paragraph (3)(A) (as of such time), reduced by the outstanding principal amount of any other qualified real property business indebtedness secured by such property (as of such time).

[29] 1017(b)(3)(F)(iii): (iii) in the case of property taken into account under section 108(c)(2)(B), the reduction with respect to such property shall be made as of the time immediately before disposition if earlier than the time under subsection (a).

(1) New law: § 108(e)(5)[30]: no COD if reduction in price of debt if: 1) original purchaser-debtor; 2) original creditor-seller;[31] 3) reduction in nonrecourse debt.
   (a) However, IRS will allow for no COD income if there is an infirmity that relates back to the original sale (e. g. where the bank might be willing to forebear during a separate tort action)
(2) Commentators: reductions by 3rd parties of debt should not be COD income to the extent that the debt is oversecured
(3) Old Law: (still might be good, but IRS says that there is no more vitality): under *Fulton Gold*: reduction or discharge of non-recourse debt did generate income without the transfer of property would reduce the basis of encumbered property (as opposed to being COD income) by the amount of debt forgiven even if the loans were held by 3rd parties. No need to show that the debt was *under-secured* (amount of debt exceeds value of collateral). If 1) debt is included in original basis of property; 2) debtor retains value of property following discharge.

ii) Service's position recourse and non-recourse should be treated the same[32]

iii) Recourse: if reduction of under-secured debt and some privity (even just tracing of proceeds) of sellers and creditors, there will be no COD **because any gain (reduction of purchase money debt) would be accompanied by a reduction in the value of the property** (they wouldn't doing it, if the property wasn't worth less) – **but the IRS and the 10th circuit think that there is COD as 108(e)(5) trumped everything. Ct. of Claims disagrees with IRS)**
   (1) No COD (except under IRS and 10th cir.) if: 1) If the amount of debt exceeds the fair market value of the property at the time of the reduction,[33]
      (a) seller is the same as creditor **or** non-seller financing[34] (or) where the proceeds can be traced[35] to the purchase of the assets securing the debt
   (2) IRS[36] and 10th Cir. Think that 108(e)(5) trumps these judicial creations

d) when a corporation exchanges stock for debt: **For purposes of determining income of a debtor from discharge of indebtedness, if a debtor corporation transfers stock to a creditor in satisfaction of its indebtedness, such corporation shall be treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the stock.** (which might not be so good, because the stock might be worth nothing)

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[30] 108(e)(5): Purchase-money debt reduction for solvent debtor treated as price reduction.--**If--**
(A) the debt of a purchaser of property to the seller of such property which arose out of the purchase of such property is reduced,
(B) such reduction does not occur--
(i) in a title 11 case, or
(ii) when the purchaser is insolvent, and
(C) but for this paragraph, such reduction would be treated as income to the purchaser from the discharge of indebtedness, **then such reduction shall be treated as a purchase price adjustment.**

[31] 92-99 (no vitality of Fulton gold with respect to 3rd party financing) – unless based on infirmity that relates back to original sale
[32] 91-31: The reduction of the principal amount of an undersecured nonrecourse debt by the holder of a debt who was not the seller of the property securing the debt results in the realization of discharge of indebtedness income under section 61(a)(12) of the Code
[33] Killian Co.
[34] Killian Co.
[35] Hextell v. Huston
[36] 92-99:

i) if a corporation has a debt to a shareholder (in his capacity as shareholder), and pays off that debt with stock, that will be treated as a gratuitous contribution to capital. The corporation will recognize debt discharge income if the shareholder reduced its basis in the **debt by claiming a bad debt deduction, or when a cash basis has not taken the amount into income**

ii) Congress repealed what was left of the common law stock for debt exception and what we have left is 108(e)(8)[37]
   (1) if a debtor corporation transfers stock to a creditor, such corporation shall be treated as having satisified the indebtedness equal to the amount of money of the FMV of the stock
   (2) in this case, they are deemed to have paid it off for the issue price of the stock
   (3) in workout situations, the value of the stock may be a good deal less than the amount of the debt
   (4) collateral consequences of a stock for debt exception
      (a) escaping taxation
         (i) only escapes recognition if Sec. 351 (gaining control) applies
         (ii) § 354: if the holder of a security disposes of it in exchange for stock, it gets non-recognition treatment **in a reorganization**[38]
         (iii)if debt is convertible by its terms, it is not a recongition
      (b) to the creditor:
         (i) if stock is transferred in satisfaction of interst part, the stock is ordinary income to the creditor – payment is applied to principal first, than to interest
            1. Under this exception, if a corporate debtor issued stock in exchange for debt, no COD income arose even when the stock was worth less than the debt satisfied[39]
            2. if the corporation is still insolvent: Service has taken the position (in an FSA) that where a corporation is insolvent, and one of these contributions made and the corporation still is not solvent, this 108(e)(6) exception doesn't apply
            3. exception for S-corporations in 108(e)(7)(C)[40]
         (ii) when the stock is sold, must recapture any gain as ordinary income.[41]

[37] 108(e)(8): Indebtedness satisfied by corporation's stock. For purposes of determining income of a debtor from discharge of indebtedness, if a debtor corporation transfers stock to a creditor in satisfaction of its indebtedness, such corporation shall be treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the stock.

[38]

[39] Motor Mart, 156 F.2d at 127

[40] 108(e)(7)©: Stock of parent corporation. For purposes of this paragraph, stock of a corporation in control (within the meaning of section 368(c)) of the debtor corporation shall be treated as stock of the debtor corporation.

[41] (7) Recapture of gain on subsequent sale of stock.--
(A) In general.--If a creditor acquires stock of a debtor corporation in satisfaction of such corporation's indebtedness, for purposes of section 1245--
(i) such stock (and any other property the basis of which is determined in whole or in part by reference to the adjusted basis of such stock) shall be treated as section 1245 property,

(c) To the corporation: current value of the debt – shareholder's basis (exception)
  (i) debt for capital: if a **shareholder-creditor** forgives the debt, under 108(e)(6): and the wants to **contribute** this debt as capital to the corporation – shareholders adjusted basis in the debt (not the fmv of the stock that comes back) will be realized. [42]: corporation realizes debt-shareholders adjusted basis in the debt
    1. Service has taken the position (in an FSA) that where a corporation is insolvent, and one of these contributions made and the corporation still is not solvent, this 108(e)(6) exception doesn't apply
    2. this really means that the COD rules in IRC section 108 apply only to the excess of the face amount of the obligation over the adjusted basis of the obligation in the hands of the shareholder.
  (ii) Stock for debt

e) if a deduction to the debtor would result from discharge of the debt, then no COD income to the debtor[43]

f) Statutory insolvency and bankruptcy
  i) Statutory insolvency (see adjustment in tax attributes)[44]: gross income doesn't includes any amount that would be included in gross income by reason of the discharge when the taxpayer is insolvent.
  ii) Bankruptcy: there is no limited to the size of discharge in bankruptcy[45] -- but must reduce tax attributes – must be title 11, and approved court
    (1) Bankruptcy must be in a title 11 case
    (2) Bankruptcy must be approved by court
      (a) Bankruptcy code says you can't declare bankruptcy solely to avoid tax

g) Preset fees: agreed upon fees and liquidated damages are not considered to be COD because they are preset by contract[46] (note: at the time there was an exclusion in the COD statute for fees)

h) Spurious discharge: agreed upon fees and liquidated damages are not considered to be COD because they are preset[47]

(ii) the aggregate amount allowed to the creditor--
(I) as deductions under subsection (a) or (b) of section 166 (by reason of the worthlessness or partial worthlessness of the indebtedness), or
(II) as an ordinary loss on the exchange,
shall be treated as an amount allowed as a deduction for depreciation, and
(iii) an exchange of such stock qualifying under section 354(a), 355(a), or 356(a) shall be treated as an exchange to which section 1245(b)(3) applies.

[42] 108(e)(6): (6) Indebtedness contributed to capital.--Except as provided in regulations, for purposes of determining income of the debtor from discharge of indebtedness, if a debtor corporation acquires its indebtedness from a shareholder as a contribution to capital--
(A) section 118 shall not apply, but
(B) such corporation shall be **treated as having satisfied the indebtedness with an amount of money equal to the shareholder's adjusted basis in the indebtedness.**

[43] 108(e)(2): **(2) Income not realized to extent of lost deductions.**--No income shall be realized from the discharge of indebtedness to the extent that payment of the liability would have given rise to a deduction.

[44] 108(a)(1)(B): the discharge occurs when the taxpayer is insolvent

[45] 108(a)(1)(A): the discharge occurs in a title 11 case,

[46] Colonial Savings

[47] Colonial Savings

i) Purchase money reductions
j) Bankruptcy and insolvency[48] (theory: a reduction of past due produces nothing of **exchangeable value** to the taxpayer[49] a.k.a. *because the taxpayer probably would never had had to pay anyway, it isn't income to discharge such a debt*)
   i) Timing of determination of size of insolvency exemption: cannot exceed the size of the insolvency **before** the discharge[50]
   ii) Amount of insolvency: This means that, before discharge must calculate the size of insolvency, then any discharge is considered to be COD, if the discharge is larger than the insolvency, than COD is only exempt to the t that discharge exceeds insolvency
      (1) This applies to both in court and out of court reorganizations because the policy is to give people a fresh
      (2) Calculating assets before discharge
         (a) Start with balance sheet
         (b) Spouses assets do not count because it does not create a new person
         (c) Have to question whether or not non-assignable goods or intangibles have value
         (d) intangibles
         (e) Exempt assets (split of authority)
            (i) Carlson: assets includes things exempt from creditors under state law
               1. (under Alaska state law, if the bank forecloses, it can only foreclose on primary residence up to the amount of fair market value).
               2. taxpayer can choose whether to rely on state or federal exemptions
               3. Thus, taxpayers with substantial exempt property should consider filing bankruptcy, even in those cases where an out-of-court restructuring is otherwise possible.
            (ii) TAM: LTR 9130005. Exempt assets are not included in assets of taxpayer (but revoked)
      (3) Liabilities
         (a) Excess non-recourse debt should not be treated as a liability[51]
         (b) Contingent liabilities: they count if there is a preponderance of evidence that it is likely that it will come due
            (i) In insolvency: All or nothing approach: must prove that the liability exists beyond a preponderance[52] (this is different than the approach used in bankruptcy)
         (c) Contested liabilities

[48] 108(d)(3) defines insolvency: **(3) Insolvent.**--For purposes of this section, the term "insolvent" means the excess of liabilities over the fair market value of assets. With respect to any discharge, whether or not the taxpayer is insolvent, and the amount by which the taxpayer is insolvent, shall be determined on the basis of the taxpayer's assets and liabilities immediately before the discharge.
[49] Dallas Transfer
[50] 108(a)(1)(B)**:** the discharge occurs when the taxpayer is insolvent,
[51] 92-53: The amount by which a nonrecourse debt exceeds the fair market value of the property securing the debt is taken into account in determining whether, and to what extent, a taxpayer is insolvent within the meaning of section 108(d)(3) of the Code, but only to the extent that the excess nonrecourse debt is discharged.
[52] Merkel

	Rev. Rul 92-53
0	General rule: non-recourse debt forgiveness not counted as a liability
1	Determine fair market value of property subject to nonrecourse note
2	Determine amount to which amount of debt exceeds value of property
3	Determine how much of the nonrecourse debt was discharged
4	Add the actual fair market value from the amount discharged
5	Determine extent of assets, using fair market value of property plus other assets
6	To determine what should be included as income only take into account recourse debt. However, this cannot exceed the amount amount that the non-recourse debt is discharged

(i) Service: not included[53]

(d) Non-recourse debt (extent of insolvency determined after discharge)

(i) amount by which a nonrecourse debt exceeds the fair market value of property securing the debt is to be taken into account in determining insolvency for § 108(d)(3) purposes, **but only to the extent that the excess nonrecourse debt is discharged**.[54] (***the IRS views the discharges as occurring simultaneously due to the prearranged plan)***

(ii) Excess nonrecourse debt that is not discharged is not treated as a liability in determining insolvency. The IRS reasoned that the legislative intent of Section 108 to provide a "fresh start" would be defeated if the discharge could generate a current tax at a time when the taxpayer was unable to pay either the debt or the tax. The ruling also provides that nonrecourse debt should be treated as a liability in determining insolvency to the extent of the fair market value of the property securing the debt. [55]

iii) Adjustment of tax attributes (for insolvency or bankruptcy.. but you can force a bankruptcy) **(selling things, and converting them to cash will reduce size of attributes)**

(1) Timing: calculate taxes due before determining tax

(a) (Take normal depreciation deduction and then reduce basis.)

(2) Can sell property and keep it in cash, so as not to have reduce the basis.

Normal under § 108(b)(2)	§ Election in 105(b)(5)

[53] TAM 8348001

[54] 92-53: amount by which a nonrecourse debt exceeds the fair market value of the property securing the debt is taken into account in determining whether, and to what extent, a taxpayer is insolvent within the meaning of section 108(d)(3) of the Code, but only to the extent that the excess nonrecourse debt is discharged.

[55] 92-53

NOL for the year of the discharge	• Reduce basis of depreciable property (but can decide how much you want to apply) and the rest goes to the normal amount. Recapture has to be ordinary.[56] (If under 1250(b) use straight line method • Limited to the adjusted basis of the depreciable property of the taxpayer in the year after the discharge[57] or liabilities after the discharge
General business credit 33 cents for every dollar excluded	
Alternative minimum tax credit 33 cents for every dollar	
Capital loss carryovers	
Basis reductions (depreciable or nondepreciable) In Bankruptcy cases or insolvency, can't reduce below the amount of bases in properties held immediately after the discharge or the liabilities after the discharge.[58] *Except property sold in*	

[56] 1017(d): Recapture of reductions.
(1) shall be made as if there had been no reduction under this section.In general. For purposes of sections 1245 and 1250—
(A) any property the basis of which is reduced under this section and which is neither section 1245 property nor section 1250 property shall be treated as section 1245 property, and
(B) any reduction under this section shall be treated as a deduction allowed for depreciation.
(2) Special rule for section 1250. For purposes of section 1250(b), the determination of what would have been the depreciation adjustments under the **straight line method** shall be made as if there had been no reduction under this section.

[57] 108(b)(5)(B):Limitation. The amount to which an election under subparagraph (A) applies shall not exceed the aggregate adjusted bases of the depreciable property held by the taxpayer as of the beginning of the taxable year following the taxable year in which the discharge occurs.

[58] 1017(b) (2) Limitation in title 11 case or insolvency. In the case of a discharge to which subparagraph (A) or (B) of section 108(a)(1) applies, the reduction in basis under subsection (a) of this section shall not exceed the excess of--
(A) the aggregate of the bases of the property held by the taxpayer immediately after the discharge, over
(B) the aggregate of the liabilities of the taxpayer immediately after the discharge.
The preceding sentence shall not apply to any reduction in basis by reason of an election under section 108(b)(5).

Reg. 1.1017-1(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. …

(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.

same year will be considered as still held.

Partnerships: an interest of a partner in a partnership is treated as depreciable real property to the extent of the partner's proportionate interest in the depreciable real property held by the partnership. The partnership's basis in depreciable real property with respect to such partner is correspondingly reduced.[59]

If you reduced your basis, any gain is going to be ordinary.

1. Reduce basis of property in following order
2. Real property in trade or business that secured the debt[60]
3. Person property held for investment (not inventory)
4. Remaining property in trade or business
5. Property not used for trade or business

Limited to the adjusted basis of the depreciable property of the taxpayer in the year after the discharge[61] or

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[59] 1017(b)(3)(C): Special rule for partnership interests.--For purposes of this section, any interest of a partner in a partnership shall be treated as depreciable property to the extent of such partner's proportionate interest in the depreciable property held by such partnership. The preceding sentence shall apply only if there is a corresponding reduction in the partnership's basis in depreciable property with respect to such partner.

[60] 1.1017-1: 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.

[61] 108(b)(5)(B): (B) Limitation. The amount to which an election under subparagraph (A) applies shall not exceed the aggregate adjusted bases of the depreciable property held by the taxpayer as of the beginning of the taxable year following the taxable year in which the discharge occurs.

liabilities after the discharge
Passive activity losses Reduce only by the amount of NOL excluded * .33 [62]
Foreign tax credit carryovers 33 cents for every dollar
Everything else is a free gift!

k) 9/11 exception: if the death of the individual and the discharge resulted from the terrorist attacks, then it is discharged (and no COD)
l) family discharges of indebtedness are considered to be gifts[63]
m) employer-employee discharges are considered to be compensation

4) calculation of size of discharge
   a) debt cancellation can be treated as debt discharge income income event though the encumbered property was sold a few months later – if there is no connection. even if debt is canceled shortly before sale of the property, it can be treated as a COD, and not as part of the sale of property[64]. (They allocated the debt discharge between the partners, and this was considered not to have substantial economic effect).
   b) Disposition by voluntary conveyance or foreclosure
      i) Recourse: **bifurcated** into deem sale up to fair market value (resulting in gain or loss), if the fair market value of the property is less than the debt the debtor realize debt discharge income
      ii) Nonrecourse
         (1) Amount realized is amount of note
         (2) No COD
         (3) Agreement to reduce amount of debt is COD
   c) Property transfers (forclosure)
      i) If property satisfies debt, for federal tax purposes it is considered an exchange[65]
      ii) Bifurcate sale into a sale (for fair market value, or appraised value) and a forgiveness[66], so the debtor realizes the amount of the sale and the forgiveness
         (1) A judicial sale is a presumption of fair market value, otherwise must prove with appraiser
         (2) A foreclosure **establishes a presumption that the fair market** value of the property is the amount bid in at the foreclosure proceeding, in the absence of clear and convincing proof to the contrary. [67]

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[62] 108(b)(3)(B): (B) Credit carryover reduction. The reductions described in subparagraphs (B), (C), and (G) shall be 33 1/3 cents for each dollar excluded by subsection (a). The reduction described in subparagraph (F) in any passive activity credit carryover shall be 33 1/3 cents for each dollar excluded by subsection (a).

[63] 102

[64] Gershowitz

[65] Hamel

[66] 90-16: The transfer of the subdivision by X to the bank in satisfaction of a debt on which X was personally liable is a sale or disposition upon which gain is realized and recognized by X under sections 1001(c) and 61(a)(3) of the Code to the extent the fair market value of the subdivision transferred exceeds X's adjusted basis. Subject to the application of section 108 of the Code, to the extent the amount of debt exceeds the fair market value of the subdivision, X would also realize income from the discharge of indebtedness

[67] Regs. Section 1.166-6(b)(2); Fair market value defined. The fair market value of the property for this purpose shall, **in the absence of clear and convincing proof to the contrary, be presumed to be the amount for which it is bid in by the taxpayer**

(3) In a voluntary reconveyance of property, an appraisal or an agreement between the parties as to the value of the property is advisable.
(4) Debt- discharge income does not arise if the debtor conveys the property to the creditor and also delivers a deficiency note to cover any shortfall between the value of the property and the amount of the debt.
(a) An insolvent or bankrupt debtor will have an incentive to value the property as low as can be supported, thus maximizing debt-discharge income at the expense of Section 1001 gain.

5) timing of discharge: look for identifiable event (which precludes enforcement). **might wanbt to accelerate because of expiring losses or insolvency exclusions**
a) if payment is a condition of discharge time of actual payment is time of discharge (not misterial receipt)[68]
b) fixing of debt amount
i) Determining whether liability is fixed or not
(1) There is not income until the liability is fixed[69]
(2) If defenses are raised to a note under state law, the liability is not fixed[70]
ii) Not COD income until dispute is resolved by court[71]
iii) Write off of debt by creditor (even if sold) : -- but if the creditors are still liable for the debt (under state law), then there is no COD income[72]
iv) Changing of debt amount to do **material modification** there is a deemed exchange of the debt for an amount of money equal to the *issue price* of the new debt.
(1) Exceptions (e. g. for forclosure)
(a) If the debt is modified at the same time as a sale or exchange, will be treated as **two transactions** if 1) the debt is assumed and the property is taken subject to the debt; 2) terms of the change would have been considered a modification anyway
(i) If the seller didn't know of the modification, then there is not considered to be an exchange[73]
(b) Election: buyer and seller can elect under 1.174-5(b)(2) to modification is treated as a separate transaction taking place immediately after the sale or exchange. **The buyer and the seller must sign a statement making the election before the earliest filing date of their federal income tax returns for the subject year; the election is made by attaching statements to their returns.**
(2) Method: bifurcate into old debt and new debt
(a) Step 1: determine if **significant** modification (looking at terms of instruments)[74]

[68] Rivera
[69] Sobel
[70] Sobel
[71] Sobel
[72] Long v. Turner
[73] 1.1274-5(b)(1) … For purposes of this paragraph (b), a debt instrument is not considered to be modified as part of the sale or exchange unless the seller knew or had reason to know about the modification.
[74] 61 FR 32926: In defining when an alteration is a modification, the final regulations also generally retain the rule that a change in a term of a debt instrument that occurs by operation of the terms of a debt instrument is not a modification. A change may occur by operation of the terms of an instrument at a specified time, as a result of a contingency specified in the instrument, or upon the exercise of an option provided for in the instrument to change a term.

(i) See if the parties **elected** to treat it is a realization event
   1. election to treat as a realization event possible if [75]
      a. debt instruments from a single new issue are substituted for debt instruments from two or more outstanding issues of old debt or debt instruments issued in a qualified reopening are substituted for debt instruments from one or more outstanding issues of debt;
      b. the substitution does not result in a significant modification of the old debt under
      c. the new debt and the old debt are publicly traded
      d. the old debt was issued at par, at a premium or with less than a de minimis amount of original issue discount or premium (within the meaning of Regs. Section 1.1273-1(d)
      e. the new debt is issued at par or with less than a de minimis amount of original issue discount or premium;
      f. neither the new debt nor the old debt is a contingent payment debt instrument
      g. neither the new debt nor the old debt is a tax-exempt obligation
      h. neither the new debt nor the old debt is a convertible debt instrument;
      i. all payments on the old debt and the new debt are denominated in, or determined solely by reference to, U.S. dollars, and the functional currency of the business unit issuing the new debt is the U.S. dollar;
      j. the issuer and one or more holders of the old debt makes the election provided in Rev. Proc. 2001-21.
   2. results of "forced recognition" election
      a. The issuer takes into account over the term of the new debt any difference between the adjusted issue prices of the old debt at the time of the substitution and the issue price of the new debt.
      b. The electing holders do not recognize any gain or loss as a result of the deemed exchange but the holder's basis (immediately after the substitution) in the new debt is the same as the holder's adjusted basis (determined as of the date of the substitution) in the debt instruments for which the new debt was substituted.
      c. In addition, the holder's holding period for the new debt includes the holder's holding period for the old debt.

[75] Regs. Section 1.1001-3. Rev. Proc. 2001- 21
Election to treat certain debt substitutions as realization events. The procedure provides for an election that allows taxpayers to treat a debt substitution, in certain circumstances, as a realization event even though it does not result in a significant modification under section 1.1001-3 of the regulations. Rev. Proc. 99-18 modified and superseded.

d. If the stated redemption price at maturity of the new debt is greater than the holder's basis (immediately after substitution) in the new debt, the holder treats the difference as market discount on the new debt and the new debt as a market discount bond.

(ii) Step 1a: is it a modification:

1. modification is defined as any alternation of a legal right or obligation of the holder or issue (including addition or delcation of a right or obligation)[76] (***ask whether or not one party would have be able to affect the same change by itself, or whether or not the debt ceases to be debt***)
   a. e. g. conversion of interest rate from floating to fixed,
   b. alternation of a debt instrument by its terms is NOT an alteration[77] (unless it substitutes a new party, or modifies the debt into something that wouldn't be considered to be a loan – e. g. conversion to equity)
   c. temporary forbearances are not modifications unless they are more than two years, or negotiations afterwards in bankruptcy[78]
   d. failure of the party to perform obligations is NOT an alternation[79]
   e. failure to exercise an option which would change the terms of the instrument[80]
   f. safe harbors that are not modifications[81]

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[76] 1.1001-3(c)(1): --(1) In general—
(i) Alteration of terms. A modification means any alteration, including any deletion or addition, in whole or in part, of a legal right or obligation of the issuer or a holder of a debt instrument, whether the alteration is evidenced by an express agreement (oral or written), conduct of the parties, or otherwise.
(ii) Alterations occurring by operation of the terms of a debt instrument. Except as provided in paragraph (c)

[77] 1.1001-3(c)(2)(ii): (ii) Alterations occurring by operation of the terms of a debt instrument.

[78] Regs. Section 1.1001-3(c)(2)(ii): (ii)
Holder's temporary forbearance. Notwithstanding paragraph (c)(1) of this section, absent a written or oral agreement to alter other terms of the debt instrument, an agreement by the holder to stay collection or temporarily waive an acceleration clause or similar default right (including such a waiver following the exercise of a right to demand payment in full) is not a modification unless and until the forbearance remains in effect for a period that exceeds—
(A) Two years following the issuer's initial failure to perform; and
(B) Any additional period during which the parties conduct good faith negotiations or during which the issuer is in a title 11 or similar case (as defined in section 368(a)(3)(A)).

[79] 1.1001-3(c)(4)(i): In general. The failure of an issuer to perform its obligations under a debt instrument is not itself an alteration of a legal right or obligation and is not a modification.

[80] 1.1001-3(c)(5): Failure to exercise an option. If a party to a debt instrument has an option to change a term of an instrument, the failure of the party to exercise that option is not a modification.

[81] Regs. Section 1.1001-3(d) examples

Modification	Not a modification
substitution of a new obligor, even though it occurs by operation of the terms of the bond Under the original terms of **a bond issued by a corporation**, an acquirer of **substantially all of the corporation's** assets may assume the corporation's obligations under the bond. Substantially all of the corporation's assets are acquired by another corporation and the acquiring corporation becomes the new obligor on the bond	The original terms of a bond provide that the bond must be secured by a certain type of collateral having a specified value. The terms also require the issuer to substitute collateral if the value of the original collateral decreases. Reset bond. A bond provides for the interest rate to be reset every 49 days through an **auction by a remarketing agent**.

i. the reset event in a reset bond;
ii. substitution of collateral pursuant to the terms of a bond;
iii. changes in interest rate pursuant to the terms of a bond;
iv. the assumption of a residential mortgage by the buyer of the residence with the consent of the holder, pursuant to the terms of the instrument, since it is through the unilateral exercise of a right;
v. the temporary waiver of an acceleration clause

(iii)Step 2b: is it a signification modification (facts and circumstances test)

1. economically significant is defined as
   a. yield: change of .25% or 5% of the yield of the bond[82]
   b. principle amount[83]
   c. timing or amounts of payments:
      i. safe harbor: not economically significant if deferred for the lesser of 5 years or ½ of the original term of the instrument[84]
   d. changes in terms
      i. change in guarantor:
      ii. adding spun- off subsidiary (***not required to file US tax returns***)as co-obligor and releasing original

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Legal defeasance (Under the terms of a recourse bond, the issuer may secure a release of the financial and restrictive covenants by placing in trust government securities that will provide interest and principal payments sufficient to satisfy all scheduled payments on the bond. Upon the creation of the trust, the issuer is released from any recourse liability on the bond and has no obligation to contribute additional securities to the trust if the trust funds are not sufficient to satisfy the scheduled payments on the bond)	The original terms of a bond provide that the interest rate is 9 percent. The terms also provide that, if the issuer files an effective registration statement covering the bonds with the Securities and Exchange Commission, the interest rate will decrease to 8 percent. If the issuer registers the bond, the resulting decrease in the interest rate occurs by operation of the terms of the bond and is not an alteration described in paragraph (c)(2) of this section
Right of first refusal (option to reduce rates instead of refinancing)	Defeasance by the terms of the bond
Terms of the note give bank the right to defer some of the payment, and the terms say that they compound at a higher rate of interst.	Exercise of an option to convert a fixed to a floating rate, but the option requires the payment of a fee based on the spread
Extension of maturity requiring consent	Option to change interest (contingent on decrease in credit rating) rate exercised Wavier of acceleration clause for less than a year

[82] 1.1001-3(e)(1) (1) General rule. Except as otherwise provided in paragraphs (e)(2) through (e)(6) of this section, a modification is a significant modification only if, based on all facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant. In making a determination under this paragraph (e)(1), all modifications to the debt instrument (other than modifications subject to paragraphs (e)(2) through (6) of this section) are considered collectively, so that a series of such modifications may be significant when considered together although each modification, if considered alone, would not be significant.

[83] The reduction in stated principal amount of the Obligation is a material modification that results in a taxable exchange of debt instruments under section 1001 of the Code. X realizes and recognizes a loss on the exchange equal to the excess of X's adjusted basis in the original Obligation over the stated principal amount of the modified Obligation. The portion of X's net operating loss, if any, for the taxable year that is attributable to this loss may be carried back 3 years and forward 15 years.

[84] 1.1001-3(e)(2),(3)

corporation as obligor on notes is substitution of obligor but not significant alteration or sale/exchange.[85]

iii. change in collateral securing
iv. charnge in priority
v. change in payment expectations[86]
vi. change in maturity date coupled with change in security was not significant[87]

e. change in obligations (or legal entitlements)
   i. Cottage Savings: a changing in the substance (swapping baskets of mortages) of the obligations is a realization event (not a COD issue)[88] – "so significant"
f. Economically significant installment sale dispositions
   i. Safe harbor (no disposition): extension of the maturity date; modification of original sales price; change in interest rate; substitution of obligors; change in interest rate from a variable to a flat rate; suspension of payments of principal for a specified period; and substitution of two installment notes for a single existing installment note, provided that such substitution only results in a change in the security.[89]
   ii. Value of disposition is handled under § 453B: difference between the basis (satisifaction in full over face value) in the obligation and the amount realized in the case of a sale or exchange or satisfaction at other than face value; or the fair market value of the obligation in all other cases. For these purposes, the holder's basis in the obligation is the excess of its face value over an amount equal to the income which would be recognized if the obligation was satisfied in full.

2. if there are multiple change must use a **cumulative** determination of what is economically significant[90]
   a. modifying several terms at once will be a deemed exchange[91]
3. involuntary exchanges (judicial exception)

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[85] PLR 9711024: Neither the addition of Controlled nor the subsequent release of Distributing as obligor on the Notes will constitute a sale or exchange within the meaning of § 1.1001-1(a

[86] 1.1001-3(e)(4) PLR 9711024

[87] 73-160: The mere extension of the maturity date of notes, accompanied by the agreement of some noteholders to be the last to have their notes redeemed, is not a taxable transaction resulting in gain or loss; G.C.M. 22056 superseded.

[88] 1.1003-1

[89] Rev. Rul. 82-122

[90] 61 FR 32926-01: Under this general rule (the general significance rule), a modification is significant if, based on all the facts and circumstances, the legal rights or obligations being changed and the degree to which they are being changed are economically significant. The general significance rule also applies to a type of modification for which specific rules are provided if the modification is effective upon the occurrence of a substantial contingency. Moreover, the general significance rule will apply for certain types of modifications that are effective on a substantially deferred basis. When testing a modification under the general significance rule, all modifications made to the instrument (other than those for which specific bright-line rules are provided) are considered collectively. Thus, a series of related modifications, each of which independently is not significant under the general significance rule, may together constitute a significant modification.

[91] 73-160

a. courts (not the IRS) hold that if it is involtary, it is not significant[92]

(b) Step 2: if it is a substantial modification value the amount of current COD

(i) Bifucate instrument into old instrument and new instrument. COD = **issue price Old** – **issue price New** (satisfies old debt with issue price of new debt)

1. if **either** instrument is publicly traded, the issue price of the new instrument is the publicly traded new instrument[93] (not face amount) (price discovery issue)
2. if neither instrument is publicly traded then the issue price of the new instrument is its face amount, unless it doesn't have adequate stated interested (go to OID rules) (discount back all payments, and include any amount below the applicable federal rate)

(3) recap

(a) is it a modification

(b) is it a significant modification is there oid

(c) if it is a significant

c) Agreements to cancel one debt for another

d) Judicial approval of settlement is required "where necessary"

e) Statute of limitations as an identifiable event

i) Death of creditor which triggers conditions will not be considered to be an identifiable event

ii) Must look to whether the state statute of limitations extinguishes or provides the debtor with an affirmative defense

f) Abandonment: if non-recourse debt is abandoned

g) Things that are not identifiable events

i) Death of creditor which triggers conditions will not be considered to be an identifiable event

ii) If the debtor is totally in control of the conditions by which the debt is discharged COD has occurred[94] (court also can look to whether there really was a gain)

iii) Agreements to cancel debt in the future[95]

iv) Conditional discharges (where the debtor can control the all conditions), this places the discharge at the time of the agreement[96]

(1) Where the conditions are so freakin' easy to meet (lacking economic substance), this will be a deemed discharge (e. g. payment of cents on the dollar over time) – goal is to prevent discretionary timing

h) Conditional discharges (where the debtor can control the all conditions), this places the discharge at the time of the agreement[97] (this makes it a gift)

i) If an unenforceable debt is paid, there is no COD, because there is no debt[98]

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[92] Mutual Loan & Savings Co. v. Comr.
[93] 1273(b)(3)
[94] Jelle
[95] Walker
[96] Shannon; Walker; Rivera
[97] Shannon; Walker; Rivera

j) Creditor forecloses on property in complete or partial satisfaction
   i) Note: state laws sometimes requires that a foreclosure be for complete satisfaction
k) Reduction in debt close in time to sale: debt cancellation can be treated as debt discharge income event though the encumbered property was sold a few months later – if there is no connection. even if debt is canceled shortly before sale of the property, it can be treated as a COD, and not as part of the sale of property[99]. (They allocated the debt discharge between the partners, and this was considered not to have substantial economic effect).

6) character of discharge
   a) payment of settlement amounts is not deductible as a business expense because the underlying loan would not have been so deductible[100]
   b) fees are not considered to be COD, if they are nzegotiated beforehand
   c) so long as there is not a connection, a discharge will be treated as COD – even if a few weeks later it is sold[101] (use "in connection with " standard)[102]
7) taxes to creditor
   a) bad debt deduction
      i) creditors allowed bad debt deduction for valid an enforceable loans (if they are business bad debts under Sec. 166)
         (1) loans between family members allowed and receive strict scrutiny
         (2) timing of bad debt is a factual determination with BOP on taxpayer
         (3) legal collection action not required if it would be futile
8) Bankruptcy estates: when an individual files for bankruptcy (under Chapter 7 or 11 that isn't dismissed) an estate is created, and taxed. This estate is separate and distinct from the person (but not from a corporation or partnership).
   a) Makeup of estate
      i) debtor's legal or equitable interests in property as of the commencement of the case[103]
      ii) things that go into the estate (enumerated in 1398)
         (1) Net operating loss carryovers: Prudential Lines, court enjoined debtor's parent from taking a worthless stock deduction after the commencement of the chapter 11 case which would eliminate the NOLs: The Second Circuit also held that the bankruptcy court had the ability, under the equitable powers conferred by 11 U.S.C. § 105(a), to enter the injunctions, given that the NOLs were property of the estate
         (2) Charitable contributions carryovers
         (3) Recovery of tax benefit items
         (4) Credits
         (5) Capital loss carryovers
         (6) Basis of assets
         (7) holding period of assets

[98] Hall
[99] Gershowitz
[100] Vukasovich
[101] Gershkowitz
[102] Gershkowitz (they were trying to avoid sale or exchange treatment, and get COD)
[103] 11 USC Section 541

(8) character of assets (including passive loss and at-risk loss rules)
(9) passive activity losses – part of regulation that provides that pre-transfer passive activity losses pass to the state might be invalid

iii) Estates use same method of accounting as debtor

iv) Abandonment of property (property the estate lets go back to the debtor)

(1) There is a split of authority as to whether or not courts can order the estate to "abandon" property, thereby subjecting it, once again, to foreclosure by the other creditors

(a) Olson: Olson reasoned that the abandonment transfer was not a sale or exchange and qualified for nonrecognition of gain or loss under Code §1398(f)(2)[104]

(b) A.J. Lane (dicta): Abandonment is a taxable event, and there was recognition (but taxable to the broke estate) when it goes back to the debt. (e.g. amount realized is the debt amount).

(c) 1.1398-1 (might be invalid)[105]: --.

(i) valid part:transfers are not treated as a disposition – and if tax consequences to a disposition.[106] **Passive activity and at- risk activity losses and credits to the list of tax attributes that pass from a debtor to the estate.**

(ii) Invalid part: attributes of pre-estate transfers pass to the estate

(2) Split of authority as to whether or not the court can order the bankruptcy estate to abandon the property

b) tax year

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[104] 1398(f)(2): Transfer from estate to debtor not treated as disposition.--In the case of a termination of the estate, a transfer (other than by sale or exchange) of an asset from the estate to the debtor shall not be treated as a disposition for purposes of any provision of this title assigning tax consequences to a disposition, and the debtor shall be treated as the estate would be treated with respect to such asset.

[105] 1.1398-1(d): Transfers from estate to debtor—

(1) Transfer not treated as taxable event. If, before the termination of the estate, the estate transfers an interest in a passive activity or former passive activity to the debtor (other than by sale or exchange), the transfer is not treated as a disposition for purposes of any provision of the Internal Revenue Code assigning tax consequences to a disposition. The transfers to which this rule applies include transfers from the estate to the debtor of property that is exempt under section 522 of title 11 of the United States Code and abandonments of estate property to the debtor under section 554(a) of such title.

(2) Treatment of passive activity loss and credit. If, before the termination of the estate, the estate transfers an interest in a passive activity or former passive activity to the debtor (other than by sale or exchange)--

(i) The estate must allocate to the transferred interest, in accordance with § 1.469-1(f)(4), part or all of the estate's unused passive activity loss and unused passive activity credit (determined as of the first day of the estate's taxable year in which the transfer occurs); and

(ii) The debtor succeeds to and takes into account, beginning with the debtor's taxable year in which the transfer occurs, the unused passive activity loss and unused passive activity credit (or part thereof) allocated to the transferred interest.

[106] TD 8537: if, before the termination of the estate, the estate transfers an interest in a passive activity or former passive activity to the debtor (other than by sale or exchange), the transfer is not treated as a disposition for purposes of any provision of the Code assigning tax consequences to a disposition.

i) normally: bankruptcy doesn't close the taxable year
ii) election: can elect to terminate the current taxable year, and create a "stump year"
(1) if there was NOL, wouldn't want to make the election
(2) election is made on or before the due date for filing the return
iii) estate can change its tax year once, as a matter of right

c) Relationship of estate to IRS
i) Service becomes a creditor of estate with respect to pre-petition taxes.
ii) Tax liabilities are "8th priority" (so, they are ahead of unsecured claims, and behind administrative claims) – so an election "deflects" a tax.

d) Effects of relief from stay
i) If a relief from stay is granted, the debtor can foreclose on property. However, the property is, in general, the property of the estate.
ii) Any gain realized would be taxable, but since the estate has no money, the gain escapes taxation.

e) Payment of taxes of the estate or of an escrow fund
i) Old rule: trustee does have to pay the taxes. This diminishes the size of the estate Holywell
ii) New rule:

9) Limitations on NOL carryovers if ownership of the corporation has changed hands
a) General rule:
i) If not an active business: regulation creates a presumption that if the acquirer of a loss corporation does not continue the corporation's business, the transaction was consummated for tax avoidance purposes[107]
ii) Specifically, Section 382 is triggered by an "Ownership Change" and provides that the amount of post-change income that may be offset by pre-change NOLs and certain built-in losses may not exceed the "Section 382 Limitation" which is generally equal to the value of the Loss Corporation multiplied by the long-term tax- exempt interest rate. [108]

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[107] 1.269-3(d): (d) Ownership changes to which section 382(l)(5) applies; transactions indicative of purpose to evade or avoid tax--(1) In general. Absent strong evidence to the contrary, a requisite acquisition of control or property in connection with an ownership change to which section 382(l)(5) applies is considered to be made for the principal purpose of evasion or avoidance of Federal income tax unless the corporation carries on more than an insignificant amount of an active trade or business during and subsequent to the title 11 or similar case (as defined in section 382(l)(5)(G)). The determination of whether the corporation carries on more than an insignificant amount of an active trade or business is made without regard to the continuity of business enterprise set forth in § 1.368-1(d). The determination is based on all the facts and circumstances, including, for example, the amount of business assets that continue to be used, or the number of employees in the work force who continue employment, in an active trade or business (although not necessarily the historic trade or business). Where the corporation continues to utilize a significant amount of its business assets or work force, the requirement of carrying on more than an insignificant amount of an active trade or business may be met even though all trade or business activities temporarily cease for a period of time in order to address business exigencies.

[108] 382(b)
(1) In general.--Except as otherwise provided in this section, the section 382 limitation for any post-change year is an amount equal to--
(A) the value of the old loss corporation, multiplied by
(B) the long-term tax-exempt rate.

(1) Ownership change is defined as is any change in the respective ownership of stock of a debtor and, after that change, the percentage of stock owned by any one 5-percent shareholder has increased more than 50 percentage points over the lowest percentage of stock owned by that shareholder during a three-year period.[109]

iii) If there is an ownership change (and not in bankruptcy) amount of NOLs that can be carried forward to the product of the value of the reorganized debtor multiplied by the long-term tax-exempt rate[110]

b) Rules are relax when corporations are reorganizing in bankruptcy (G Reorgs)

i) C reorgs: bankrupt corp must transfer "substantially all" of its assets to qualify as a tax free reorg[111]

(1) Substantially all is defined as

(a) 70% of the gross assets and 90% of the net assets of the transferor benefits[112]

(b) legislative history: more lenient

(c) analogous authority (D-reorg); 15% is substantial[113]

ii) G reorgs[114] -- looser requirements than C reorgs. Only need to transfer the ownership to qualified creditors

(1) qualified creditors are debtors to whom the stock was issued in satisfaction of a debt that was held least 18 months prior to commencement of the

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(2) Carryforward of unused limitation.--If the section 382 limitation for any post-change year exceeds the taxable income of the new loss corporation for such year which was offset by pre-change losses, the section 382 limitation for the next post-change year shall be increased by the amount of such excess.

[109] 382(g)(1),(2)

[110] For example, the debtors in the Conseco chapter 11 cases estimated that the general rule of § 382(b) could have, depending on the market value of the equity in the reorganized company, limited them to approximately $ 7 million of NOL carryforwards per year, destroying about $ 1.12 billion of NOLs having a potential tax savings of approximately $ 392 million. If possible, debtors are well-served by avoiding a plan of reorganization that results in an ownership change

[111] 368(a)(1)(C): the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other shall be disregarded;

[112] Rev. Proc 77-37 Sec. 3.01: 01 The "substantially all" requirement of sections 354(b)(1)(A), 368(a)(1)(C), 368(a)(2)(B)(i), 368(a)(2)(D), and 368(a)(2)(E)(i) of the Code is satisfied if there is a transfer (and in the case of a surviving corporation under section 368(a)(2)(E)(i), the retention) of assets representing at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by the corporation immediately prior to the transfer. All payments to dissenters and all redemptions and distributions (except for regular, normal distributions) made by the corporation immediately preceding the transfer and which are part of the plan of reorganization will be considered as assets held by the corporation immediately prior to the transfer.

[113] Smothers v. US

[114] 368(a)(1)(G): a transfer by a corporation of all or part of its assets to another corporation in a title 11 or similar case; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356.

bankruptcy case or that arose in the ordinary course of the debtor's business and that has been held by the same creditor at all times[115]

(2) alternative rule for to become a qualified debtor: at least 5% ownership, even if the debt was purchased after the commence of the case.[116]

iii) General limits on use of NOLs outside bankruptcy.[117]

(1) Each year can only use the value of the old loss corporation * the long-term tax-exempt rate

(2) May be carried forward

(3) No trading of shell corporations: Must be continuously carried on[118]

iv) Normal: 382(l)(5) – NOLs can only be used up to a certain amount and only for two years.

(1) Requirements

(a) company has to be in bankruptcy

(b) the shareholders have to emerge with 50% or more after the reorganization (they can't be 50% stockholders because they put new money in)

(i) if they did put new money in, the limitation would apply, if that is the case, then the limitation doesn't apply except to a small extent that the amount of the NOL is reduced by interest that is paid with stock

(ii) stock to count in making the determination: 18 month limit

1. was held by the creditor at least 18 months before the date of the filing of the title 11 or similar case, or

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[115] 382(l)(5)(e): Only certain stock taken into account.--For purposes of subparagraph (A)(ii), stock transferred to a creditor shall be taken into account only to the extent such stock is transferred in satisfaction of indebtedness and only if such indebtedness--

(i) was held by the creditor at least 18 months before the date of the filing of the title 11 or similar case, or

(ii) arose in the ordinary course of the trade or business of the old loss corporation and is held by the person who at all times held the beneficial interest in such indebtedness

[116] 1.193-2(d)(3): Treatment of certain indebtedness as continuously owned by the same owner--(i) In general. For purposes of paragraph (d)(2) of this section, a loss corporation may treat indebtedness as always having been owned by the beneficial owner of the indebtedness immediately before the ownership change if the beneficial owner is not, immediately after the ownership change, either a 5-percent shareholder or an entity through which a 5-percent shareholder owns an indirect ownership interest in the loss corporation (a 5-percent entity). This paragraph (d)(3)(i) 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.

[117] (b) Section 382 limitation.--For purposes of this section--

(1) In general.--Except as otherwise provided in this section, the section 382 limitation for any post-change year is an amount equal to--

(A) the value of the old loss corporation, multiplied by

(B) the long-term tax-exempt rate.

[118] 382(c): (c) Carryforwards disallowed if continuity of business requirements not met.--

(1) In general.--Except as provided in paragraph (2), if the new loss corporation does not continue the business enterprise of the old loss corporation at all times during the 2-year period beginning on the change date, the section 382 limitation for any post-change year shall be zero

2. arose in the ordinary course of the trade or business of the old loss corporation and is held by the person who at all times held the beneficial interest in such indebtedness

(2) Toll charge: the reorganized debtor's NOLs are reduced by the amount of interest paid or accrued on the debt converted into equity under a plan during the tax year in which the ownership change occurs and during the three prior tax years.[119]

(3) Later changes in ownership: If during the **two years** after the ownership change there is another yet another ownership change (e.g. they sell it) then the 382 limit drops to zero

(a) Or if it is not a continuous business ownership limits on use will drop to zero as well

(b) Taking a worthless stock deduction will deem a 50% ownership change to have occurred, and in *Prudential Lines* the Bankruptcy court has jurisdiction to enjoin this from happening[120]

v) Election: 382(l)(6)[121] – special valuation rule but NOLs can be (1) used forever: Under section 382(1)(6), the section 382 limitation (use of the net operating loss each year is limited to the value of the equity of the loss corporation multiplied by the long-term, tax-exempt bond rate) applies, however, the limitation is based on the enhanced value of the corporation after the ownership change (not taking into account the value of the debt). Section 382(1)(6) has encouraged companies that reorganize to issue large amounts of stock for debt, resulting in a much more favorable balanced capital structure

(1) Specifically, the value of the reorganized debtor is the lesser of (a) the value of the stock in the reorganized debtor immediately after the

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[119] 382(l)(5)(B). (B) Reduction for interest payments to creditors becoming shareholders.--In any case to which subparagraph (A) applies, the pre-change losses and excess credits (within the meaning of section 383(a)(2)) which may be carried to a post-change year shall be computed as if no deduction was allowable under this chapter for the interest paid or accrued by the old loss corporation on indebtedness which was converted into stock pursuant to title 11 or similar case during--

(i) any taxable year ending during the 3-year period preceding the taxable year in which the ownership change occurs, and

(ii) the period of the taxable year in which the ownership change occurs on or before the change date.

[120] 382(g)(4)(d): Treatment of worthless stock.--If any stock held by a 50-percent shareholder is treated by such shareholder as becoming worthless during any taxable year of such shareholder and such stock is held by such shareholder as of the close of such taxable year, for purposes of determining whether an ownership change occurs after the close of such taxable year, such shareholder--

(i) shall be treated as having acquired such stock on the 1st day of his 1st succeeding taxable year, and

(ii) shall not be treated as having owned such stock during any prior period.

For purposes of the preceding sentence, the term "50-percent shareholder" means any person owning 50 percent or more of the stock of the corporation at any time during the 3-year period ending on the last day of the taxable year with respect to which the stock was so treated.

[121] 382(l)(6): Special rule for insolvency transactions.--If paragraph (5) does not apply to any reorganization described in subparagraph (G) of section 368(a)(1) or any exchange of debt for stock in a title 11 or similar case (as defined in section 368(a)(3)(A)), the value under subsection (e) shall reflect the increase (if any) in value of the old loss corporation resulting from any surrender or cancellation of creditors' claims in the transaction.

ownership change or (b) the value of the debtor's pre-confirmation assets aka instead value the old loss corporation taking into account the effect of any debt canceled in the reorganization or a stock-for-debt exchange

(2) No "toll charge"

(3) NOL can be used forever

10) Passing attributes between partnerships and corporations: Discharge of indebtedness is unlikely in a partnership bankruptcy case unless the partners are themselves insolvent

a) S-corps: COD does not increase basis

b) COD exclusions are determined at the "partner level" – not the partnership level[122]

i) Real property held by partnership

(1) Qualified real property

(a) Determining whether things are qualified real property are made with regard to whether or not the partnership was involved in that trade or business.[123]

(i) Election is made at partner level[124]

(ii) Depreciable real property held by partnership: an interest of a partner in a partnership is treated as depreciable real property to the extent of the partner's proportionate interest in the depreciable real property held by the partnership. The partnership's basis in depreciable real property with respect to such partner is correspondingly reduced.[125]

c) COD will be allocated to the partners, provided that there is substantial economic effect (so a failure to include a deficit restoration obligation will result in allocations being made according to the partners economic interests)

i) One partner might be able to qualify for an exclusion and one might not

ii) To determine whether it is qualified real estate, one looks at it at the partnership level[126]

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[122] 108(e)(6): Indebtedness contributed to capital.--Except as provided in regulations, for purposes of determining income of the debtor from discharge of indebtedness, if a debtor corporation acquires its indebtedness from a shareholder as a contribution to capital--

(A) section 118 shall not apply, but

(B) such corporation shall be treated as having satisfied the indebtedness with an amount of money equal to the shareholder's adjusted basis in the indebtedness.

[123] H. Rep. No. 103-11 (5/19/93).

[124] 108(d)(6): Certain provisions to be applied at partner level. In the case of a partnership, subsections (a), (b), (c), and (g) shall be applied at the partner level.

703(b) Elections of the partnership.--Any election affecting the computation of taxable income derived from a partnership shall be made by the partnership, except that any election under—

(1) subsection (b)(5) or (c)(3) of section 108 (relating to income from discharge of indebtedness

[125] 1017(b)(3)(C): Special rule for partnership interests.--For purposes of this section, any interest of a partner in a partnership shall be treated as depreciable property to the extent of such partner's proportionate interest in the depreciable property held by such partnership. The preceding sentence shall apply only if there is a corresponding reduction in the partnership's basis in depreciable property with respect to such partner.

[126] 92-97

iii) Allocations of indebtedness to an insolvent partner: Partnership special allocations lack substantiality when the partners amend the partnership agreement to specially allocate COD income and book items from a related revaluation after the events creating such items have occurred if the overall economic effect of the special allocations on the partners' capital accounts does not differ substantially from the economic effect of the original allocations in the partnership agreement[127]

d) Admissions of new partners who pay the debt

i) Any relief of debt is treated as a cash distribution[128] -- in a partnership this could result in a deemed discharge of debt

(1) partners partnership basis includes the money they contributed plus their shares of parternship debt

(2) their basis is then adjusted, going forward but what they take out of the partnership, and then increased

(3) the basis, in another way they look at it, is the capital account plus their share of liabilities

ii) if a creditor is admitted as a partner

(1) debt remains outstanding:

(2) if the lender is a partner the liability is allocated for tax purposes (for basis purposes)

(3) non-recourse debt would become recourse debt (752 has an exception)

iii) if the creditor exchanges the debt for a partnership interest

(1) we will substitute for the $1m in debt, a partnership interest in its capital and in its profits and losses – does this swap of a partnership interst, does this trigger COD income

(2) (there used to be a stock for debt exception, which didn't trigger COD income – even though the stock could be less than the face amount of the debt) – the concept was that the debt wasn't really canceled, it lived in the form of stock, under 108(e)(8)

(3) the argument was made that the exclusion of corporation, did not exclude a similar aranagement for partnerships

11) responsible person liability: 100% penalties under 6672

a) size of tax: everything government due expect for employee's share of FICA

i) income and employment (social security and railroad taxes) or collected excise taxes

b) elements

[127] 99-43

[128] Example: Consider a scenario where a partner files a voluntary Chapter 7 bankruptcy petition, lists his share of the partnership's secured debt on his bankruptcy petition, and obtains a discharge of his share of the partnership's recourse secured debt. If the debtor's partnership interest reverts back to him after the bankruptcy case is closed, the effect of the bankruptcy discharge creates a deemed partnership distribution to the debtor partner equivalent to the amount of his share of the partnership recourse debt discharged in the bankruptcy, which could have disastrous tax consequences for the debtor partner. A deemed distribution resulting from a decrease in a partner's share of partnership liabilities is treated as an advance or drawing of money under the relevant IRC provisions. The partner recognizes income pursuant to I.R.C. Section 731 to the extent that a deemed distribution exceeds his basis in the partnership. The forgiveness of debt provisions of I.R.C. Section 108 does not apply in this instance.

i) **Required to collect, account, and pay over**
(1) wide definition of responsible person
(2) "only following orders" not a defense
(a) however, someone who is instructed to sign the checks is not liable, unless they have actual authority to make the decisions[129]
(3) a general manager who can decide what creditors to pay is responsible[130]
ii) Failure
iii) **willfully fail to do so**
(1) at the time the person was a responsible person, they had to have knowledge that the tax was unpaid, or if they didn't have that knowledge, they had to not have that knowledge due to a reckless disregard
(2) must have been money "available" to pay the tax –
(a) encumbered cash is not "available"
(3) someone' s "ability" is judged from the time they become responsible persons. So, is for taxes that accrue after they become responsible parties[131]
(4) no reasonable cause defense[132]

c) payment to government
i) Brugier: payment by a company on the eve of bankruptcy is not a preference, because it is a payment
ii) setting up an installment plan: can enter into an installment plan, but the company will owe not only trust fund taxes, but non-trust fund taxes
(1) but IRS will not assert penalties against people in these positions[133]
iii) can go into bankruptcy, but bankruptcy plan must provide for payments to the government within six years
(1) The government may object to payment of the plan first, claiming that the reorganization won't be successful.
(a) can get the trustee to agree to litigate since this will make the plan work better
(i) Bankruptcy court can order the designation of payments as trust fund payments if necessary to carry out the reorganization[134] (not

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[129] Haffa
[130] Gephart
[131] Slodov: We hold that a "responsible person" under § 6672 may violate the "pay over" requirement of that statute by willfully failing to pay over trust funds collected prior to his accession to control when at the time he assumed control the corporation has funds impressed with a trust under § 7501, but that § 7501 does not impress a trust on after-acquired funds, and that the responsible person consequently does not violate § 6672 by willfully using employer funds for purposes other than satisfaction of the trust-fund tax claims of the United States when at the time he assumed control there were no funds with which to satisfy the tax obligation and the funds thereafter generated are not directly traceable to collected taxes referred to by that statute
[132] Monday: The standard of willfulness should not be construed to include lack of 'reasonable cause' or 'justifiable excuse.' These concepts tend to evoke notions of evil motive or bad purpose which properly play no part in the civil definition of willfulness
[133] P-5-60
[134] Energy Resources: A bankruptcy court has the authority to order the IRS to treat tax payments made by Chapter 11 debtor corporations as trust fund payments where the court determines that this designation is necessary for the success of a reorganization plan. Although the Bankruptcy Code does not explicitly authorize such a court to approve reorganization plans designating tax

liquidation[135]) plan – to carry out provisions of the bankruptcy code[136] (reorganization or similar purpose): -- even if this prejudices their collection of other taxes and relieves individuals of personal liability[137]

1. to order designation must be in persuit of the bankruptcy code

(b) there is a question as to whether this applies under a liquidation plan

iv) personal bankruptcy will not extinguish these debts[138]

d) where lenders can be liable: [139] if they pay employees directly and don't pay the government

i) lenders makes direct payment to the employees: personal liability
(1) monies collected go to government

ii) supply funds: if a lender makes a payment to the employer and knows that the employer won't pay over tax there is personal liability (up to 25%)
(1) monies collected go to government

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payments as either trust fund or nontrust fund, the orders at issue are wholly consistent with the court's broad authority under the Code to approve plans including "any appropriate provision not inconsistent with ... this title," 11 U.S.C. § 1123(b)(5), and to "issue any order ... necessary or appropriate to carry out the [Code's] provisions," § 105.

[135] Kare Kemical, Inc.

[136] Pepperman

[137] Deer Park

[138] Pepperman

[139] 3505:a) Direct payment by third parties.--For purposes of sections 3102, 3202, 3402, and 3403, if a lender, surety, or other person, who is not an employer under such sections with respect to an employee or group of employees, pays wages directly to such an employee or group of employees, employed by one or more employers, or to an agent on behalf of such employee or employees, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages by such employer.

(b) Personal liability where funds are supplied.--If a lender, surety, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1)) that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax required by this subtitle to be deducted and withheld by such employer from such wages, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which are not paid over to the United States by such employer with respect to such wages. However, the liability of such lender, surety, or other person shall be limited to an amount equal to 25 percent of the amount so supplied to or for the account of such employer for such purpose.

(c) Effect of payment.--Any amounts paid to the United States pursuant to this section shall be credited against the liability of the employer