



Debt Workout – Oh how taxing it can be!

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When Borrowers Need to Call

- **If you want to negotiate a loan write-down or turn over the property to the lender**
- **If you or your affiliate plans to buy back your publicly-traded debt at a discount**
- **If you want to redeem a note for equity or a hope note**

Tax Planning Paths

1. Sell/Relinquish the property

- **Relief from personal guaranty**
- **Amount realized (gain) if debt is nonrecourse**
- **Cancellation of indebtedness income if debt is recourse**

Tax Planning Paths

2. Retain property with new debt/capitalization structure

- **Recourse v. nonrecourse debt**
- **Forgiveness of principal amount**
- **Debt modification**
 - **Extension of maturity date**
 - **Interest rate reduction**
 - **A/B note split**
 - **Relief of personal guaranty**
 - **White Knight/Rescue financing**
 - **Additional Funding**

Exclusion of COD Income Under IRC sec. 108

- **Bankruptcy and insolvency exclusions**
- **Qualified real property business indebtedness**
- **Reduction of tax attributes**

What is COD and What Triggers It?

- **Whenever a borrower's debt is satisfied for less than the full amount of the debt, COD income is generated.**
- **COD income is taxed at ordinary income tax rates.**
- **Some workout techniques that may cause COD:**
 1. **Loan write-downs**
 2. **Borrower or affiliate acquires debt at a discount.**
 3. **Debt for equity exchange at a discount**
 4. **Certain debt modifications**

COD Exceptions

- **Bankruptcy exception – make sure COD is AFTER filing bankruptcy**
- **Insolvency exception – limited to amount of insolvency**
- **The cost of either exception is the reduction of tax attributes**

Insolvency Exception Example

- **Facts:**

- Total outstanding debt before discharge: **\$60 million**
- FMV of all assets before discharge: **\$40 million**
- Amount of debt after discharge: **\$35 million**

- **Results:**

- **\$20 million excluded (attributes reduced)**
- **\$5 million net taxable COD**

Real Property Business Indebtedness Exception

- **Allows taxpayer to swap COD for write down of tax basis in property**
- **Limited to 1) excess of debt over FMV of real property and 2) tax basis of depreciable real property**
- **Qualifications:**
 1. **Property must be used in a trade or business**
 2. **Acquisition indebtedness**
 3. **Secured by real property – certain mezzanine loans may not qualify**

New Section 108(i) Deferral

- **For debt acquired by the borrower in 2009 and 2010**
- **Recognize income ratably over five year period**
- **Must be elected at the partnership level although individual partners can elect out**
- **Continuing trade or business requirement**
- **Once elected, taxpayer cannot use any of the exclusions (i.e. bankruptcy, insolvency, etc.)**



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COD Exceptions	Property eligible	Loans eligible	Other Limitations or Considerations	Costs of applying exception
Insolvency	All	All	If borrower is partnership, ultimate partner must be insolvent	Reduce tax attributes
Bankruptcy	All	All	If borrower is partnership, ultimate partner must be bankrupt	Reduce tax attributes
Real Property Business Indebtedness	Only depreciable real property	Only acquisition debt and only debt directly secured by real property	If sufficient basis in secured property, can elect to reduce basis in other property; not available for C corporations	Potential ordinary income recapture if later sell the property
Section 108(i) Deferral	All	Only loans written down in 2009 or 2010	Not applicable to foreclosure or deed-in-lieu for single property entity; continuing business	Temporary deferral; cannot later use other exceptions; reporting requirements

Take-Aways and Q&As

- **If historic lender, understand borrower/debt investor's economic motivations**
- **If borrower, know your COD exceptions before you ask for forgiveness**
- **If still worried, CALL YOUR TAX PERSON!**

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