

NEW CANCELLATION OF INDEBTEDNESS RULES

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The recently enacted American Recovery and Reinvestment Tax Act contains new rules for cancellation of indebtedness ("COD") income, which could be of major importance for you.

In general, the cancellation or reduction of the principal amount of indebtedness gives rise to immediate, ordinary COD income, unless the debtor is in bankruptcy, or is insolvent and not rendered solvent by the cancellation. This rule creates a tax hardship for debtors who are hurting economically and who are attempting to work out or restructure their debts in order to avoid insolvency proceedings.

To mitigate the harshness of this rule, the Act provides that companies (or related persons) which reacquire debt instruments issued in connection with the conduct of a trade or business can elect to report the resulting COD income ratably over five taxable years, beginning with the 2014 taxable year—a significant deferral. This election, however, is available only for indebtedness which is reacquired in 2009 or in 2010, so prompt consideration of its potential applicability is recommended. Under the new law, a reacquisition includes not only a straight cancellation of the debt, but also the

repurchase by the debtor (or a related person) of a debt instrument for (i) cash, (ii) another debt instrument, (iii) common stock (not preferred stock) or a partnership interest issued in exchange for the debt, and/or (iv) the contribution of the debt instrument to the debtor's capital. This relief is available not only to corporate debtors but to partnerships, LLCs and S corporations as well. A further benefit of this election is that the debtor is not required to reduce tax attributes such as net operating losses, or to write down the basis of its assets, by reason of the deferred COD income.

As you can imagine, there are a host of technical issues (e.g., original issue discount considerations) relating to this provision but, such complexities notwithstanding, this new law affords you extremely valuable tax relief. Real estate developers and private equity funds may particularly benefit from this provision, and we call this change to your attention in the hope that you may benefit from it.

Please contact Dennis L. Cohen (215.665.4154, dcohen@cozen.com) or Richard J. Silpe (215.665.2704, rsilpe@cozen.com) if you would like more information or assistance with this provision.