JONES DAY

Jones Day Tax Practice: Bankruptcy and Restructuring

The Trends

A distressed company and its creditors risk losing valuable tax benefits without proactive, clear-thinking, and experienced tax counsel.

Debtor Tax Considerations. A primary issue is cancellation of debt income (CODI) recognized on debt discharges, amendments, exchanges, and other liability management exercises. In chapter 11 cases before a bankruptcy court, a debtor's CODI can be excluded from tax if the discharge occurs pursuant to a plan confirmed or order approved by the court. Out of court, an insolvency exception may be available to the extent that liabilities exceed asset fair market value. Absent such exceptions, CODI absorbs valuable net operating losses (NOLs) and tax credits resulting in a cash tax on unsheltered income exceeding the 80% NOL limitation and the interest expense limitation. A trade-off for relying on the bankruptcy or insolvency exception is a reduction in a debtor's NOLs, tax basis, and other tax attributes by the excluded CODI after the close of the tax year. Here is where excellent tax lawyers can shine, reorganizing a debtor's organizational structure before year-end.

A second pressing issue is to determine whether a more than 50% change in ownership will occur, in which case a debtor's ability to use its pre-change NOLs to offset future income will be compromised. Here too tax counsel is imperative to press for a lock-up or first-day order to protect from an ownership change and attribute loss outside the context of a confirmed plan and to scope out the government's anticipated tax law changes regarding calculating limitations on NOLs.

Debtors may emerge from bankruptcy via a chapter 11 plan or section 363 sale, either of which may be structured as tax-free or taxable, or through a foreign restructuring regime. Tax counsel can bring experience and imagination to model alternatives towards an optimal tax structure.

Creditor Tax Considerations. Key tax priorities for U.S. creditors such as banks, asset managers, and private credit funds are to avoid forfeiting their tax loss in the restructuring and, where they take an equity interest, to evaluate a possible asset-basis step-up to create valuable tax attributes that could generate future deductions.

For offshore funds, offshore investors in U.S. funds, CLOs, and non-U.S. banks, the pressing issues are to avoid withholding taxes on fees or restructuring support payments and to avoid actions that deem the creditor to be engaged in a U.S. trade or business or generate taxable U.S. income.

Foreign Debt Restructurings Recognized in the United States. Of late, U.S. debtors affiliated with non-U.S. companies are increasingly seeking debt relief under foreign debt restructuring statutory regimes. Chapter 15 of the bankruptcy code enables a U.S. bankruptcy court to recognize the discharge of a debtor under a foreign restructuring statutory regime. In addition, it allows a non-U.S. debtor to access the U.S. bankruptcy court if it has U.S. assets. The sale of those assets may trigger U.S. tax liabilities, and the IRS or a state taxing authority may file claims in the bankruptcy to assert its right to taxes owed on U.S. assets.

How We Can Help

Tax lawyers should be the differentiator in bankruptcy cases, out-of-court debt restructurings, and liability management exercises, working together with the company, restructuring professionals, and creditors to maximize tax attributes and minimize cash tax leakage. Jones Day has long been recognized as premier in this space and has the sole tax lawyer elected in the last decade as a conferee of the National Bankruptcy Conference.

We devise novel structures to apply the Tax Code's favorable bankruptcy tax provisions coupled with chapter 15 restructuring proceedings involving U.S. debtors restructuring debts under foreign statutory regimes. We efficiently structure creditor premiums in the now prevalent scenario where lenders agree to participate in a debtor-in-possession (DIP) loan and members of ad hoc groups of creditors agree to participate in a rights offering for a negotiated amount of premiums to be paid in the form of reorganized company stock. Following *Loper Bright*, we consider the use of the bankruptcy court as a forum to challenge tax regulations lacking regulatory authority. We model tax structuring alternatives independently and in coordination with the debtor's accounting firm and financial advisors.

Who Will Be Impacted?

The distressed companies, board, CEO, CFO, Tax VP, those charged with preserving corporate value, investors, and creditors must make decisions net of taxes that erode recoveries and investments at a debtor's most vulnerable time. Jones Day tax lawyers are embedded with our bankruptcy deal team of restructuring, finance, and corporate lawyers from the outset of any transaction, driving structure and strategy.

Key Contacts

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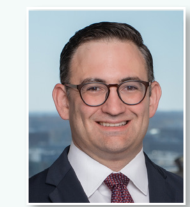

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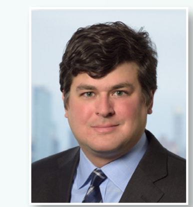

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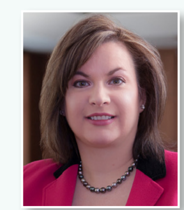

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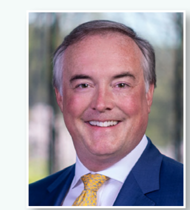

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