IRS May Release Interim Guidance Upon Expiration of Signing Date Rule

by Amy S. Elliott

The IRS may not be able to finish substantive guidance regarding the signing date rule in temporary regulations governing the continuity of interest requirement for corporate reorganizations before the rule expires March 19, said Lee Kelley, IRS deputy associate chief counsel (corporate).

The Service is "considering what measure we might be able to implement in the event that we're not quite done with the substantive work by the date that the regs are set to expire," said Kelley, speaking at a session on troubled and failing corporations at the Domestic Corporate Tax panel of the 34th annual Federal Bar Association Section on Taxation Tax Law Conference in Washington on March 5.

Kelley added that the IRS has received requests to make the rules accommodate transactions with a collar option -- a purchase price containment mechanism used in some cases to protect target shareholders from a decline in value of the acquiring stock. She said the IRS is thinking about whether to add that flexibility to the rule (found in reg. section 1.368-1T(e)(2)). (For prior coverage, see *Doc 2010-1741* or *2010 TNT 16-6*. For T.D. 9316, see *Doc 2007-6854* or *2007 TNT 54-12*.)

Distressed Debt

Practitioners questioned whether promised clarifications to an ambiguity in reg. section 1.1001-3 would be consistent with the preamble to the regs. Reg. section 1.1001-3 concerns whether modifications to a debt instrument, for instance in a workout, would trigger a retesting of the instrument's debt/equity status.

Jeffrey Van Hove, deputy counsel in Treasury's Office of Tax Legislative Counsel, said that any anticipated guidance wouldn't change the rule but merely clarify where it would apply. He said it would address whether financial deterioration should be ignored.

"That was the comment that the government embraced, but the scope of the embrace is what's in question," Van Hove said. "We're going to stick with the concept of financial deterioration and then just clarify where it applies."

Practitioners also wanted to know exactly how the IRS was planning to narrow the potential application of reg. section 1.382-2T(f)(18)(iii), which concerns treating debt as stock for purposes of the section 382 ownership change rules.

"It's likely that we would not come out with a rule that says it never applies to debt," said Kelley. "If this reg never applied to debt, the scope would be really narrow because if debt were treated as equity under general tax principles, you don't need this rule."

She did provide some insight to the relief the Service is considering by adding that "generally speaking, public trading of impaired debt really shouldn't cause this reg to apply."

Practitioners debated the necessity of the rule to police "vultures" from buying up debt to take over a target company. Mark Hoffenberg, a principal in the corporate tax group at KPMG LLP's Washington National Tax practice, said section 382 was designed to police something different -- vultures putting in new assets and benefiting from the net operating loss carryforwards of the target company.

Gordon E. Warnke, a partner at Dewey & LeBoeuf LLP, pointed out that "if I'm buying the debt and ultimately going to convert it into equity, why should I be able to pick the timing of my change?"

The panelists discussed the rule in the context of a recent private letter ruling in which notes trading at a significant discount were not treated as stock. Robert Liquerman with KPMG LLP said that he understood the letter ruling to mean that public trading doesn't seem to concern the IRS regarding this rule

"I think that's a fair observation," said Kelley, pointing out that section 382 has its own provisions that apply in cases of bankruptcy and that "it would seem odd" to make a rule that interfered with those provisions. (For LTR 200938010, see *Doc 2009-20781* or *2009 TNT 180-27*.)

All-Cash D Regs

Practitioners at a separate session spoke about the final regulations on all-cash D reorganizations and a proposal, previously offered by Donald Bakke, attorney-adviser in Treasury's Office of Tax Legislative Counsel, to avoid the nominal share mechanics of the regs by issuing a small amount of transferee stock. (For prior coverage, see *Doc 2010-230* or *2010 TNT 3-2*.)

Robert H. Wellen, a partner at Ivins, Phillips & Barker, wondered whether such efforts to try to avoid application of the nominal share rule should be aggressively policed by the government. He suggested that without the policing, the rule would die off at the hands of sophisticated tax practitioners who don't like the answer given in the regs

Lisa M. Zarlenga of Steptoe & Johnson LLP asked whether the IRS would consider issuing rulings on what constitutes de minimis variations in ownership under the all-cash D regs. Steve Fattman, counsel, IRS Office of Associate Chief Counsel (Corporate), said he assumes the Service would rule on that.