



**No. 157**  
**Tuesday, August 18, 2009**  
**Page G-2**  
**ISSN 1522-8800**



## Federal Tax & Accounting

### Debt Instruments

#### **IRS Includes Favorable Partial Election Option In Guidance on COD Income Deferral Election**

Practitioners commended the Internal Revenue Service for including a partial election option in highly anticipated procedural guidance (Revenue Procedure 2009-37) issued Aug. 17 on making the tax code Section 108(i) election to defer the recognition of cancellation of indebtedness (COD) income.

Section 108(i), enacted as part of the American Recovery and Reinvestment Act of 2009 (Pub. L. No. 111-5), allows certain creditor taxpayers to file an election at the partnership level to defer recognized COD income from the reacquisition of an applicable debt instrument after Dec. 31, 2008, and before Jan. 1, 2011, for up to five years.

Treasury Department officials had previously stated that they were working to issue guidance on the issue by the end of the summer (106 DTR G-6, 6/5/09 ). Steve Frost, senior counsel at Treasury's Office of Tax Policy, said at the American Bar Association Section of Taxation meeting May 8 that the government needs to release several pieces of guidance on the election but stressed the urgency to get something out as soon as possible in order to address questions surrounding the election process (88 DTR G-10, 5/11/09 .

#### **Partial Election Helpful to Partnerships**

Steven Schneider of Goulston & Storrs, Washington, D.C., said the revenue procedure is very favorable to partnerships, particularly because IRS is allowing taxpayers to make partial elections and permitting partnerships to choose which partners defer which amount, if any. The procedure also provides that a taxpayer is not required to make an election for the same COD income portion arising from each reacquired applicable debt instrument, though he or she may make an election for different portions of such income arising from different applicable debt instruments.

"We were worried about the problem an 'all or nothing' election would create if one partner wanted it and another one didn't since the election is made at the partnership level," Schneider said in an e-mail. "They fixed this problem by allowing the partnership

to elect to defer just a portion of the COD and then specially decide which partner the election applied to.”

Andrea Macintosh Whiteway, partner at McDermott Will & Emery LLP, Washington, D.C., said the guidance makes Section 108(i) “more workable and appealing” to partnerships. Rev. Proc. 2009-37 mitigates some of the problems partnerships faced with partners that have divergent interests and now enables them to, in effect, make the election at the partner level, although the partnership will administer it, she said.

David Schnabel, partner at Debevoise & Plimpton LLP, New York, said IRS provided an “elegant solution” to the mandate in the statute that the election be made at the partnership level. The one complaint about the election when it was first enacted was that it had to be made at the partnership level when most of these decisions are made at partner level, he said. Allowing partial elections “is a very constructive solution, I think, to that problem,” he said.

Many partnerships would have difficulty agreeing on whether or not to make the election without the ability to treat separate partners differently, since the election is not always advantageous to each partner because they are often in different positions, Schneider told BNA. Allowing partial elections frees up the ability of partnerships to utilize this election more, he said.

IRS took a logical approach to the issue by permitting a partial election, Schneider said. The ABA Section of Taxation asked IRS to include an opt-out allowance for partners in its May 5 comments on the Section 108(i) election, but nothing in the statute precludes IRS from permitting a partial election, he said.

### **Future Regulations**

Schneider told BNA he thinks taxpayers will generally be happy with what IRS has issued. Seeing proposed regulations on the election this year would be optimistic, though possible, he said. “The rush was for this,” Schneider said, referring to the revenue procedure.

Schneider said he would expect rules to come out early in 2010, though it is uncertain how much time the service will devote to a special two-year rule. In the procedure, IRS stated its intent to publish additional guidance that may include regulations on items included in Rev. Proc. 2009-37. “Taxpayers should be aware that these regulations may be retroactive,” the agency said.

The agency plans to issue regulations concerning the computation of the earnings and profits of a corporation with regard to COD income and original issue discount (OID) deductions that are deferred under Section 108(i), according to the guidance. These rules will generally provide that “deferred COD income increases earnings and profits in the taxable year that it is realized and not in the taxable year or years that the deferred COD income is includible in gross income,” IRS said. Deferred OID deductions will generally decrease earnings and profits in the taxable year or years in which the deduction would be permitted without regard to 108(i), it said.

IRS said it also plans to issue rules providing exceptions for certain special status corporations. These regulations would provide that, in the case of regulated investment companies (RICs) and real estate investment trusts (REITs), COD income deferred under Section 108(i) “generally increases earnings and profits in the taxable year or years in which the deferred COD income is includible in gross income and not in the year that the

deferred COD income is realized," it said. Deferred OID deductions generally decrease earnings and profits in the taxable year or years that such deductions are deductible, IRS said.

#### **Time, Manner for Elections Addressed**

The revenue procedure also included a protective 108(i) election in case a taxpayer is unsure if he or she has COD income but does not want to miss the deadline, Schneider said in an e-mail. The guidance provided the manner in which a taxpayer makes such an election.

The procedure describes specific procedures for partnerships, S corporations, tiered passthrough entities, and foreign entities to make the election, IRS said. The guidance also requires taxpayers who make the election to provide additional information on returns starting with the taxable year succeeding the taxable year for which the election is made, it said.

To make the Section 108(i) election, a taxpayer must attach a statement containing required information described in Rev. Proc. 2009-37 to a timely filed, original federal income tax return for the taxable year in which the applicable debt instrument is reacquired, IRS said. IRS is granting an automatic 12-month extension of the due date prescribed in the guidance for making the election, it said.

The revenue procedure is scheduled for publication Sept. 8 in Internal Revenue Bulletin 2009-36.

*By Lauren Gardner*