LexisNexis Tax Advisor -- Federal Topical

Part 2. Taxpayer Groups

Vol. 2D Partnerships & LLCs

CHAPTER 2D:3 Tax Accounting for Partnerships and Limited Liability Companies **

LexisNexis Tax Advisor -- Federal Topical § 2D:3.03

§ 2D:3.03 Elections Affecting Partnership or LLC Income

...

[6] Election to Defer Recognition of Debt Discharge Income in 2009 and 2010

A taxpayer realizes debt discharge income when it reacquires its own obligation for less than the issue price. New IRC Section 108(i) allows partnerships and other businesses to make an irrevocable election to defer recognition of income from the cancellation of business debt reacquired in 2009 or 2010. That income is deferred until the 5th year after the reacquisition (4th year for reacquisitions in 2010). The deferred amount is then included in the taxpayer's income ratably over the following 5 years.

A taxpayer that makes the election may not exclude the income from the cancelled debt under any other code sections that might apply in the election year or in any later year. Accordingly, an electing taxpayer cannot exclude the debt discharge income under the provisions applicable to Title 11 bankruptcy, insolvency, qualified farm indebtedness, or qualified real property business indebtedness. For example, an insolvent taxpayer that elects to defer debt discharge income under IRC Section 108(i) cannot later exclude that income and reduce tax attributes under other provisions of IRC Section 108.

For purposes of IRC Section 108(i), a *reacquisition* is any *acquisition* of an *applicable debt instrument* by the debtor that issued (or is the obligor under) the debt instrument, or a person related to that debtor. An *acquisition* of an *applicable debt instrument* includes:

- acquisition of the debt instrument for cash,
- exchange of the debt instrument for another debt instrument (including an exchange resulting from modification of the debt instrument),
- exchange of the debt instrument for corporate stock or a partnership interest,
- contribution of the debt instrument to capital, and
- forgiveness of the indebtedness by the holder of the debt instrument

An *applicable debt instrument* is any *debt instrument* issued by a C corporation, or any other person in connection with the conduct of a trade or business. A *debt instrument* is a bond, debenture, note, certificate, or any other instrument or contractual arrangement constituting indebtedness within the meaning of IRC Section 1275(a)(1).

...

[7] Elections Made by Partners

...

[b] Discharge of Indebtedness

...

[viii] Exchange of Partnership Interest for Discharged Debt

...

PRACTICE NOTE: The Service has issued proposed regulations regarding the determination of cancellation of indebtedness (COD) income of a partnership that transfers a partnership interest to a creditor in satisfaction of the partnership's indebtedness (debt-for-equity exchange). The proposed rules provide:

- *Valuation of Partnership Interest Transferred in Satisfaction of Partnership Debt*

IRC Section 108(e)(8) provides that in determining the COD income of a debtor partnership, the partnership is deemed to satisfy the indebtedness with an amount of money equal to the fair market value of the interest transferred to the creditor. The amount by which the indebtedness exceeds the fair market value of the transferred partnership interest is COD income included in the distributive shares of the partners in the debtor partnership immediately before the discharge.

Under the proposed regulations, the partnership and the creditor may value the transferred partnership interest in a debt-for-equity exchange (debt-for-equity interest) based on liquidation value. For this purpose, liquidation value equals the amount of cash the creditor would receive for the debt-for-equity interest if, immediately after the transfer, the partnership sold all of its assets (including goodwill, going concern value, and other intangibles associated with partnership operations) for cash equal to the fair market value of those assets, and then liquidated. The creditor's capital account in the partnership increases by the fair market value of the indebtedness exchanged.

...

If [prescribed liquidation value] conditions are not satisfied, the value of the debt-for-equity interest is determined by considering all the facts and circumstances.