Bailout and NOL Rules: What, Me Worry?

By Robert W. Wood • Wood & Porter • San Francisco

Keeping pace with federal legislation is often daunting. That’s particularly true when bills are churned out in rapid succession, often with a paucity of debate or markup. It’s fair to say that many of the recent bills coming out of Congress in this post-FDR-quasi-New Deal era have their focus on the gloomy financial world, not on tax law. Inevitably, though, tax law enters into the mix. Indeed, there are a number of tax provisions in the Housing and Economic Recovery Act of 2008 (“Housing Act”). There are also plenty of tax provisions in the Emergency Economic Stabilization Act of 2008 (with its heehaw sounding EESA acronym).

Loss Limitation Failsafe

As readers of THE M&A TAX REPORT are all too aware, Code Sec. 382 provides for limitations on the use of NOLs any time there is an ownership change of a loss corporation. Once this trigger is depressed, the taxable income of the loss corporation for any post-change tax year generally cannot be offset by any pre-change loss carryovers, except to a limited extent. And, the limited extent is awfully limited.

The so-called Code Sec. 382 limitation only allows you to chip away at your erstwhile NOL at a rate that often feels like you are using a Lilliputian rock hammer to chip away at Mount Everest. Code Sec. 382(m) directs the IRS to issue regulations to carry out the purposes of Code Sec. 382. As we are all too aware, usually those regulations are complex and generally not taxpayer friendly.

Yet, in a “me too” move that adds one more positive spin to Treasury bailout largesse, the IRS says it will issue regulations under Code Sec. 382(m) to exempt transactions in which the U.S. directly or indirectly acquires a more than 50-percent ownership interest. More controversially, there’s some other guidance too, but I’m getting ahead of our story.
Plain Old Losses
The Housing Act authorizes the Treasury to purchase obligations and securities. In Notice 2008-76, IRB 2008-39, 768, the IRS announced it will issue regulations under Code Sec. 382(m) to address the application of the Code Sec. 382 NOL rules to certain acquisitions in which the U.S. acquires a more than 50-percent interest (which can be either direct or indirect) in a loss corporation.

The way the IRS proposes to do this is to simply say that, with respect to a loss corporation, the “testing date” will not include any date on or after the date on which the U.S. directly or indirectly acquires a more than 50-percent interest in the loss corporation (or an option to acquire it). These regulations will apply for any tax year on or ending after September 7, 2008.

Notice 2008-76 was evidently designed to avoid an ownership change with respect to Fannie May and Freddie Mac. Then, Notice 2008-84, IRB 2008-41, 1, used a similar approach to expand the range of corporations that are protected from an ownership change due to government action. Although there will be plenty of other beneficiaries, one big one may be AIG.

Happy Banks
Then there’s Notice 2008-83, IRB 2008-42, 1, dealing with Code Sec. 382(h) and changes of ownership involving banks, mutual savings banks and even domestic building and loan associations. Investment banks aren’t so clear. Even so, Notice 2008-83 appears to turn off the net unrealized built-in loss rules and the recognized built-in loss rules, which would otherwise make these corporations hamstrung by Code Sec. 382 like everyone else.

If you need proof that flipping an ostensibly small and seemingly technical switch like this can have a big real-world tax impact, consider that this little IRS announcement may have been the straw that moved Wells Fargo to pursue its $15 billion grab of Wachovia. [See Taub, IRS Addresses Loss Limitations Avoid Financial Crisis, TAX NOTES, Oct. 20, 2008, at 277.] More broadly, scores of banks may now do deals with a dramatic turnback-the-clock-decades—disregard for the Code Sec. 382 loss limitations that Congress imposed.

In fact, some estimate that Wells Fargo will save a whopping $19.4 billion as a result of the IRS largesse. [See Taub, Bank Deals Are Getting Hefty IRS Breaks, CFO.com, Oct. 31, 2008, www.cfo.com/article.cfm/12538516/c_12539422?f=home_todayinfinance.] PNC Financial’s takeover of National City may save $5.1 billion. [Id.] Banco Santander, S.A., acquiring the remaining assets of Sovereign Bancorp, may save big bucks too. Senator Charles Schumer of New York has grumbled about the respective roles of the IRS and Congress in such strokes of the pen.

Notice 2008-78, IRB 2008-41, 1, imparts a similar theme to capital contributions, the idea presumably being that capital contributions should be especially encouraged these days. The Notice indicates that notwithstanding Code Sec. 382(l)(1)(B), a capital contribution will not be presumed to be part of a plan a principal purpose of which is to avoid or increase the Code Sec. 382 limitation solely as a result of having been made in the two year period ending on the change date.

Thus, a capital contribution would be disregarded (regardless of its timing) only if
based on the facts and circumstances, it is part of a plan a principal purpose of which is to avoid or increase the Code Sec. 382 limitation. Notice 2008-78 goes on to list a couple of safe harbors from even having to undergo the facts and circumstances gauntlet.

**Conclusion**

It is way too soon to say just how radically the financial crisis will reshape Wall Street, Main Street or the considerably financial topography in between. That makes it also way too soon to assess how big an impact these various get-out-of-NOL-jail-free cards will have. Even so, as Senator Grassley grumblingly remarked about Congress’ writing of Code Sec. 382 and the IRS’s big relief by notice efforts, these are huge and decisive changes. Secretary Paulson has now said Treasury officials believed the treatment of built-in losses was discouraging bank mergers, which represented worthwhile activity. He has also defended the administrative process producing Notice 2008-83 as “quite legal.” [TAX NOTES, Nov. 17, 2008, at 797.]

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**Fear & Loathing in Code Sec. 409A**

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As we enter the post-election and current economic malaise, M&A TAX REPORT readers are no doubt braced for a new raft of tax bills. These tax bills, like those of the recent past, are apt to have vainglorious names. Although I recognize that sometimes something is what you call it, I still wish we could have tax acts that were titled like tax acts. What is wrong with calling something the “Tax Reform Act of [BLANK]?”

In 2004, the *nom de plume* was the American Jobs Creation Act of 2004, which, by the way, despite its feel good name, included within it a number of tax increases. One increase came in the form of heightened scrutiny (and just plain disallowance) to a number of relatively tried and true deferred compensation arrangements. Think 409A.

With the enactment of new Code Sec. 409A, a cynic might say that the Internal Revenue Code has become such a behemoth that we must now resort to letters as well as numbers. Of course, a cynic might also say that Code Sec. 409A helped the law that enacted it live up to the name hype of the Jobs Act. If nothing else, the Jobs Act certainly led to job creation in executive compensation consultants, tax lawyers and accountants in that field.

**Big Job**

At its root, Code Sec. 409A provides that amounts deferred under a nonqualified deferred compensation plan must be currently included in gross income if they are not subject to a substantial risk of forfeiture, and have not previously been included in gross income. That sounds harsh. Yet, there is a large “but” that allows you to meet certain requirements to fall *outside* this harsh rule, and back into what one would think of as traditional (pre–Jobs Act) deferred compensation rules.

The current *lingua franca* holds that a nonqualified deferred compensation plan includes virtually any agreement, method, program or other arrangement that provides for deferral of compensation, where the compensation is not paid until a later tax year. One of the initial stumbling blocks about the scope of this provision is just what constitutes a “plan.”

The following types of arrangements and agreements are among the many types of arrangements that are covered by the broad (and some might say grasping) reach of Code Sec. 409A:

- Any employment, bonus or compensation agreement (even if it covers only one employee!) that results in the deferral of the taxation of compensation
- Supplemental executive retirement plans (sometimes called SERPs), and other nonqualified retirement arrangements
- Restricted stock, phantom stock and performance share plans
- Code Sec. 457f plans
- Certain stock appreciation rights
- Many long-term or multi-year bonus or commission programs

One might assume from the expansiveness of this list that caution is appropriate. Talk about understatement. In fact, the expansiveness may