

# Section 382(l)(5) Prop. Regs. Broaden Relief

by Robert W. Wood • San Francisco

The question of who is a qualified creditor is of some moment within the context of Section 382(l)(5). That provision allows an acquisition to occur in bankruptcy without the hindrance of the Section 382 rules limiting the use of NOLs. (See "Proposed Regs. Deal With NOLs in Insolvency," 1 *M&A Tax Rep't* 2 (September 1992), p. 7, and "RRA '93 Hastens Death Knell for Bankrupt Corporations," p. 5, this issue.) To take advantage of this favorable provision, though, the acquirers must either be existing stockholders before the bankruptcy, or must be "qualified creditors." The Service has now taken a second stab at describing just who those qualified creditors are.

The proposed regulations, released in May, supersede proposed regulations that were published in September 1991. The new release generally follows the 1991 version. "Qualified creditor" and "qualified indebtedness" are defined in the same way as they were in the earlier version. "Ordinary course indebtedness" is also treated virtually in the same manner as it was before.

## Widely Held Debt

The treatment of widely held indebtedness is improved, however. The new proposed regulations add a *de minimis* rule that allows a loss corporation to treat indebtedness as always having been owned by the beneficial owner immediately before the ownership change if, immediately after the ownership change, the beneficial owner is neither a 5% shareholder nor an entity through which a 5% shareholder owns an indirect ownership in the loss corporation.

For purposes of the rule, a 5% shareholder includes any person who is a 5% shareholder of the loss corporation within the meaning of Temp. Reg. 1.382-2T(g). However, in making this determination, the option attribution rules of Temp. Reg. 1.382-2T(h)(4) do not apply. There is an exclusion from the *de minimis* rule for indebtedness owned by a person whose par-

ticipation in formulating a plan of reorganization makes evident to the loss corporation that the person has not owned the debt for the requisite period.

## Tacking Ownership Periods

Another significant change from the 1991 proposed regulations concerns tacking of ownership. Since the general definition of qualified indebtedness requires an 18-month holding period, tacking from one owner to another obviously could be important. Under the new proposed rules, a transferee of indebtedness in a "qualified transfer" is treated as having owned the indebtedness for the period that it was owned by the transferor for purposes of determining whether it is qualified.

A "qualified transfer" includes transfers between related parties, in satisfaction of a right to receive a pecuniary bequest, pursuant to a divorce or separation agreement, by reason of subrogation, or if the transferee's basis is determined under Section 1014 or 1015 or by reference to the transferor's basis. In a bad-intent provision typical of recent regulatory releases however, a transfer of debt is not a qualified transfer if the transferee acquired the debt primarily to benefit from the losses of the loss corporation. ■

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