

# NATIONAL BANKRUPTCY CONFERENCE

A Voluntary Organization Composed of Persons Interested in the  
Improvement of the Bankruptcy Code and Its Administration

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April 23, 2020

*Re: Economic Crisis Caused by SARS-CoV-2 Virus -- Reenactment of Section 108(i) of the Internal Revenue Code*

Dear Sens. McConnell and Grassley, and Reps. Pelosi and McCarthy:

The National Bankruptcy Conference (“NBC”) has been devoted to the improvement of the Bankruptcy Code and its predecessors for more than 80 years. We applaud the actions Congress has taken in response to the spread of the SARS-CoV-2 Virus, including those measures designed to ensure that our bankruptcy system will operate as intended to help individuals in financial distress obtain a fresh start and to facilitate the reorganization of troubled businesses. We also support actions taken by Congress to aid small businesses and to amend the Internal Revenue Code in ways that should reduce the number of bankruptcy filings by companies and ultimately help to preserve industries and jobs, as addressed in our prior letter of March 22, 2020.

As you consider further legislation, we strongly recommend that Congress reenact Section 108(i) of the Internal Revenue Code. Section 108(i) was enacted during the Great Recession of 2009 to facilitate the restructuring of corporate obligations outside of bankruptcy. Section 108(i) applied to years 2009 and 2010 and was effective in easing the consequences of the 2009 financial crisis. We believe Congress should once again enact a new version of Section 108(i) for the situation created by the SARS CoV-2 pandemic. Indeed, the need for this immediate relief may even exceed the need in 2009.

Without Section 108(i), the mere amendment of a debt instrument outside of bankruptcy (even without any reduction in the amount owed) can result in adverse tax consequences. Under Section 1001 of the Internal Revenue Code and

Treasury Regulation § 1.1001-3, a debtor recognizes cancellation of indebtedness income if it amends a debt instrument in a way that causes a “significant modification” and the debt instrument is traded on an “established securities market” (including interbank markets). This adverse tax consequence arises even if the amount that the debtor owes is not reduced or cancelled, and even if the amendment is intended to benefit the lender.

Consider the following scenario: A company is healthy when the pandemic hits and can be healthy again once the economy reopens. Its debt trades in the debt market (an “established securities market” is very broadly defined). During the pandemic, its business comes to a complete halt, and it needs temporary relief from its creditors such as modifying financial covenants or deferring amortization requirements, possibly even deferring the payment of interest until the pandemic ends. Its lenders are willing to accommodate these changes because they believe the company will be viable once the economy reopens -- there is no plan to reduce the amount owed. But under Internal Revenue Code Section 1001, these changes to the terms of the debt instrument would cause the company to recognize taxable cancellation of indebtedness income if its debt trades for a price that is less than the amount of the obligation. In other words, the company recognizes cancellation of indebtedness income even though there is no cancellation of indebtedness. Many companies are currently reaching exactly these types of debt agreements with their lenders, modifications that will hopefully keep the companies out of bankruptcy. And because literally thousands of American companies have debt that trades in the debt market, we expect this will be a widespread tax consequence. Indeed, this tax problem is currently complicating many negotiations between lenders and borrowers.

This problem is not a small problem. It is our understanding that approximately 90% of publicly traded debt instruments are trading at 90 cents on the dollar or less. Approximately 40% of such debt instruments are trading at 80 cents on the dollar or less. These numbers are 10 times greater than they were two months ago. As a result, the vast majority of businesses with traded debt are now unable to modify their debt obligations without realizing substantial taxable income from the recognition of completely “phantom” income. The Internal Revenue Code includes provisions to protect companies in bankruptcy and companies that are insolvent from recognizing this income, but there is nothing in the Code to protect companies that are not yet in bankruptcy or insolvent from recognizing this phantom income.

As discussed above, this was a major problem in 2009. Congress addressed it by enacting Section 108(i): if a company realized cancellation of indebtedness income in 2009 or 2010, it could defer recognizing the taxable income from the “deemed” cancellation until the years 2014-2018. Deferring the tax liability until 2014-2018 was an efficient solution, because when a debtor recognizes cancellation of indebtedness income from a “deemed cancellation,” the issue price of the debt instrument also is reduced for tax purposes, thereby increasing subsequent interest deductions from the debt instrument. Those interest deductions are then available to offset the subsequent recognition of the debt cancellation income. The solution Congress fashioned in 2009 worked well and helped the economy: it enabled companies to restructure their debt outside of

bankruptcy without triggering adverse tax consequences for a nonexistent debt reduction.

We recommend Congress reenact Section 108(i) for all debt exchanges occurring on or after January 1, 2020. It enabled companies to restructure out of court during the Great Recession and we believe it can do so again in the face of the pandemic. A significant increase in corporate bankruptcy filings resulting from COVID is likely unavoidable, but we believe that a reenacted Section 108(i) can reduce that number, benefitting our bankruptcy system and more importantly, our economy.

Sincerely,

*/s/ Jane Vris*

Jane Vris, Chair

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# NATIONAL BANKRUPTCY CONFERENCE

*A non-profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws.*

**History.** The National Bankruptcy Conference (NBC) was formed from a nucleus of the nation's leading bankruptcy scholars and practitioners, who gathered informally in the 1930's at the request of Congress to assist in the drafting of major Depression-era bankruptcy law amendments, ultimately resulting in the Chandler Act of 1938. The NBC was formalized in the 1940's and has been a resource to Congress on every significant piece of bankruptcy legislation since that time. Members of the NBC formed the core of the Commission on the Bankruptcy Laws of the United States, which in 1973 proposed the overhaul of our bankruptcy laws that led to enactment of the Bankruptcy Code in 1978, and were heavily involved in the work of the National Bankruptcy Review Commission (NBRC), whose 1997 report initiated the process that led to significant amendments to the Bankruptcy Code in 2005. Most recently, the Conference played a leading role in developing the Small Business Reorganization Act of 2019, Pub. L. 116-54.

**Current Members.** Membership in the NBC is by invitation only. Among the NBC's 60 active members are leading bankruptcy scholars at major law schools, as well as current and former judges from eleven different judicial districts and practitioners from leading law firms throughout the country who have been involved in most of the major corporate reorganization cases of the last three decades. The NBC includes leading consumer bankruptcy experts and experts on commercial, employment, pension, mass tort and tax related bankruptcy issues. It also includes former members of the congressional staff who participated in drafting the Bankruptcy Code as originally passed in 1978 and former members and staff of the NBRC. The current members of the NBC and their affiliations are set forth on the second page of this fact sheet.

**Policy Positions.** The Conference regularly takes substantive positions on issues implicating bankruptcy law and policy. It does not, however, take positions on behalf of any organization or interest group. Instead, the NBC seeks to reach a consensus of its members - who represent a broad spectrum of political and economic perspectives - based on their knowledge and experience as practitioners, judges and scholars. The Conference's positions are considered in light of the stated goals of our bankruptcy system: debtor rehabilitation, equal treatment of similarly situated creditors, preservation of jobs, prevention of fraud and abuse, and economical insolvency administration. Conferees are always mindful of their mutual pledge to "leave their clients at the door" when they participate in the deliberations of the Conference.

**Technical and Advisory Services to Congress.** To facilitate the work of Congress, the NBC offers members of Congress, Congressional Committees and their staffs the services of its Conferees as non-partisan technical advisors. These services are offered without regard to any substantive positions the NBC may take on matters of bankruptcy law and policy.

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