382 Bailout Guidance

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Like everyone else, M&A Tax Report readers may be getting tired of bailout news. After all, with all the changes of ownership that have occurred at the federal trough, corporate tax aficionados could hardly help thinking about Code Sec. 382 and its NOL restrictions. It wasn't all that long ago (last October to be exact) that the IRS issued Notice 2008-100, IRB 2008-44, 1081. This notice provided guidance on the application of Code Sec. 382 to loss corporations whose instruments are acquired under the capital purchase programs of the Emergency Economic Stabilization Act of 2008. For discussion, *see* Wood, *Bailout and NOL Rules: What, Me Worry?* M&A Tax Report, Dec. 2008.

For anyone affected by these rules, however, a great deal of caution and thought (and maybe even a little soul-searching) seems required.

Once is never enough, of course, and the IRS has now issued Notice 2009-14, IRB 2009-7, Jan. 30, 2009. As we'll see, the hits just keep on coming.

Something Old, Something New

Code Sec. 382 imposes limits after an ownership change on the amount of a loss corporation's taxable income for any post-change year that can be offset by pre-change losses. The limitation for each year is equal to the product of the fair market value of all of the stock of the loss corporation immediately before the ownership change, multiplied by the applicable long-term tax exempt rate.

Yet if the loss corporation has a net unrealized built-in gain (NUBIG) on the change date, the Code Sec. 382 limitation for any tax year ending within a five-year recognition period is increased by the recognized built-in gain for the tax year, subject to the NUBIG limitation.

How Do You Spell Relief?

As we all now know, the Emergency Economic Stabilization Act authorized the Treasury Secretary to establish the Troubled Asset Relief Program (TARP). (Yes, it's tempting to put a tarp over all of it.) Under it, Notice 2009-14 provides guidance to corporate issuers regarding five different programs established under the Emergency Economic Stabilization Act:

- The Capital Purchase Program for publicly traded issuers
- The Capital Purchase Program for private issuers
- The Capital Purchase Program for S corporations
- The Targeted Investment Program
- The Automotive Industry Financing Program

For all of these programs, taxpayers are supposed to be able to rely on the Notice 2009-14 precepts. They are complicated, and this summary only scratches the surface. With that disclaimer, here are the basics:

Debt and Preferred Stock Acquired by the Treasury

Any instrument issued to Treasury under any of the five programs (interestingly, whether owned by Treasury or any subsequent holders) will be treated as debt if denominated as such, and as stock if denominated as preferred stock. No instrument is treated as stock for purposes of Code Sec. 382 while it is held by Treasury or by other holders, except that preferred stock is treated as stock for purposes of the Code Sec. 382(e)(1) rule regarding valuation.

Warrants Acquired by the Treasury

Any warrant to purchase stock under a number of the programs (but significantly, not for the Capital Purchase Program for private issuers, or the Capital Purchase Program for S corporations) is treated as an option and not as stock. While held by the Treasury, these warrants are not deemed exercised. There are special rules regarding the warrants acquired by the Treasury under the S corporation or private Capital Purchase Programs.

Code Sec. 382 Treatment of Stock

For any stock (other than preferred stock) acquired by the Treasury under any of the five programs (directly or on exercise of warrants), the Treasury's ownership will not be considered to have caused the Treasury's ownership in the issuing corporation to have increased over its lowest percentage owned on any earlier date.

Code Sec. 382 Treatment of Redemptions

If stock is redeemed that is held by the Treasury (and that was acquired by the Treasury under any of the Programs), for purposes of measuring shifts in ownership by any five-percent shareholder on any testing date, the stock redeemed is treated as if it had never been outstanding.

Capital Contributions from the Treasury

Finally, capital contributions made by the Treasury under the Programs are not considered to have been made as part of a plan, a principal purpose of which was to avoid or increase any Code Sec. 382 limitation. In other words, this turns off the normal Code Sec. 382(l)(1) rules.

Watch out

How Code Sec. 382 should apply to companies affected by the various bailout programs has become a controversial subject. Notice 2008-100 and now Notice 2009-14 provide some guidance. For anyone affected by these rules, however, a great deal of caution and thought (and maybe even a little soul-searching) seems required.