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Cross-Border Corporate Restructurings

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- Key concepts
  - Debt Cancellation/Waiver
  - Losses
  - Intercompany Debt

- Examples

Summary of Key Concepts

Jurisdiction	Debt Waiver	NOL Carryforward	Intercompanies
United States	• Generally creates taxable income • Special exclusions for bankruptcy and insolvency subject to attribute reduction • Can be triggered by debt modifications and swaps • Can be triggered by debt for equity exchanges	• Generally carried forward indefinitely for losses after 2017 • Subject to significant limitation from a “change of control”, a term of art. • Special exceptions for bankruptcy and insolvency	• Can be contributed to capital or exchanged for equity, but form matters • Special care must be taken for cross border obligations • Income can be triggered from related party acquisitions
Germany	• Generally creates taxable income • Special exemption in certain restructuring circumstances; subject to attribute reduction	• Indefinite carryforward, limited carryback • Limited offset and subject to elimination on change of control subject to special exceptions	• Waivers are generally hidden capital contributions up to value of debt
Luxembourg	• Generally creates taxable income • Special insolvency exemptions subject to limitations • Taxable gain on debt for equity swap	• Generally carried forward for 17 years for losses after 2017; subject to anti-abuse rules	• Waivers are hidden capital contributions up to value of debt
Netherlands	• Generally creates taxable income • Exemption in case of uncollectible debt if certain conditions are met subject to use of attributes	• Indefinite carryforward, limited carryback. • Subject to restriction if ultimate interest changed substantially (30%)	• Generally taxable if arm’s length but then typically waiver profit exemption. Alternatively, could be exempt if disguised contribution to capital

Summary of Key Concepts

Jurisdiction	Debt Waiver	NOL Carryforward	Intercompanies
United Kingdom	• Generally follows accounting treatment • Special exclusions for insolvency/corporate rescue • Debt for equity exchange exception • Special rules for modifications of debt that are substantial modifications for accounting purposes	• In theory indefinite carry forward provided same trade or business continues • But subject to “change of ownership” rules where there is a material change in the nature of the trade/business or significant increase in capital	• Exclusions where the companies are “connected” • Special rules for related party purchases
Italy	• Generally creates taxable income • Can be triggered by debt for equity exchanges • Special rules for insolvency and bankruptcy subject to attribute reduction • Special care should be taken in cross border situations • Can be triggered by modifications	• Carried forward indefinitely subject to an abuse of law standard after a change of control/change of business • “Vitality test” exception	• Debt waivers by shareholders can be taxable • Special care should be taken in cross border situations
Switzerland	• Generally creates taxable income, subject to offset by NOLs • Special insolvency rules for recapitalizations • May create withholding tax	• 7 year carryforward subject to a potential abuse of loss standard	• Generally also creates taxable income offset by deduction • Stamp duty may arise

U.S. Cancellation of Debt Income (CODI)

- Under general US tax principles, a borrower does not recognize taxable income when it receives loan proceeds because it has an obligation to repay the loan.
- If the borrower is later relieved of such repayment obligation, the borrower recognizes cancellation of debt income ("CODI") that is taxable. IRC § 61(a)(11). The fundamental tenet is that the forgiveness of the indebtedness results in an increase in the debtor's net worth. This can occur:
  - Where the debtor or a person "related" to the debtor repurchases its own debt at a discount to par (whether for cash, stock, or a new debt instrument).
  - Debtor and creditor agree to a "significant modification" of the terms of a debt instrument, creating a deemed exchange of the "old" debt instrument for the "new" debt instrument under IRC § 1001 and either the old or new debt instrument is treated as "traded on an established market."
  - Debt is cancelled in connection with a bankruptcy/insolvency transaction.
- There are several exceptions and exclusions to recognizing CODI as taxable income. Most important: bankruptcy and insolvency. IRC § 108(a)(1)(A) + (B). Other common exceptions:
  - Liabilities to extent payment would have resulted in a deduction. IRC § 108(e)(2).
  - Contributions to capital. IRC § 108(e)(6).

U.S. – CODI –Bankruptcy & Insolvency Exclusions - IRC § 108(a)(1)(A) & (B)

Bankruptcy Exclusion

- Debt cancellation must occur in the bankruptcy case and debtor must be under the jurisdiction of the bankruptcy court (IRC § 108(a)(3)).
- Bankruptcy refers to a Title 11 case (including Chapter 15 recognition).
- If bankruptcy exclusion applies, all CODI is excluded, even if debtor is not insolvent.
  - In the US, debtor doesn't have to be insolvent to file for bankruptcy (subject to good faith requirement, which has historically not been widely utilized, even in circumstances that are arguably egregious (for non-tax reasons)).
  - Not uncommon to file for bankruptcy largely to have the benefit of the bankruptcy exclusion instead of having to rely on the insolvency exclusion.

Insolvency Exclusion

- More limited than bankruptcy exclusion – applies only to the extent of the insolvency
  - CODI often exceeds insolvency in an out-of-court workout because equityholders receive a "tip."
  - Potential valuation disconnects between trading value of debt and bottom's-up valuations done for debt or GAAP purposes, e.g., debt trading for 70 cents on dollar receives 100% of equity but all parties value the equity at 75. What controls insolvency determination?
    - What if creditors get a combination of non-traded debt and equity, where the trading value of the old debt would in fact be determinative for the new debt's issue price?
    - This kind of disconnect/concern is what is most likely to deter taxpayers from relying on the insolvency exclusion, as "bottom's-up" valuations are very commonly higher than debt trading price valuations.

U.S. – CODI – Attribute Reduction

- Exclusion of COD income under IRC § 108(a) (due to bankruptcy or insolvency) results in a reduction of tax attributes.
- In general, attribute reduction occurs in the following order:
  - NOLs that would otherwise be generated in year of discharge
  - NOL carryovers from prior years (oldest first)
  - General business credits
  - Minimum tax credits
  - Net capital losses & capital loss carryovers
  - Tax basis of assets (see IRC § 1017)
  - Passive activity losses
  - Foreign tax credit carryovers

U.S.– Significant Modifications of Debt

- If debt is modified or exchanged and the terms of the unmodified ("old") debt differ from the modified ("new") debt to the extent that the Treasury Regulations deem "significant" then there is a deemed exchange of the "old" debt for the "new" debt.
- Main categories:
  - Change in yield of more than the greater of 25 bps or 5% of the annual yield of the unmodified debt. Fees, change in principal and other payments taken into account.
  - Changes in timing of payments – safe harbor of lesser of 5 years and 50% of original term.
  - Changes in obligor or security (sometimes it depends)!
  - Changes in recourse nature.
  - Exchange for property that isn't debt – special rule for troubled companies.
- If there is a public value available for "old" debt or "new" debt in the 31 days around the modification date, then the exchange value will be based on the price of the "new debt", if available, or if not on the the price of the "old" debt.
  - Can lead to significant CODI.
- If no public value available, exchange usually assumes par.

U.S. – Pitfalls of Intercompany Debt

- Treas. Reg. § 1.61-12(c)(2)(ii)
  - Issuer realizes CODI upon repurchase of debt at a discount, with the CODI equal to the excess of the adjusted issue price over the repurchase price.
- IRC § 108(e)(6)
  - If a debtor corporation acquires its indebtedness from a shareholder as a contribution to capital, IRC § 118 does not apply, but such corporation shall be treated as having satisfied the indebtedness with an amount of money equal to the shareholder's adjusted basis in the indebtedness.
- IRC § 108(e)(8)
  - If a debtor corporation transfers stock to a creditor in satisfaction of its indebtedness, such corporation shall be treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the stock.
- IRC § 108(e)(10)
  - If a debtor issues a debt instrument in satisfaction of indebtedness, such debtor is treated as having satisfied the indebtedness with an amount of money equal to the issue price of such debt instrument.
- Treas. Reg. § 1.1001-3
  - A reduction of principal could result in a significant change in yield, thereby resulting in a deemed exchange of "old debt" for "new debt“ (see, e.g., Treas. Reg. § 1.1001-3(g), Ex. 3).

U.S. – Ownership Change Limitation on Attributes

- IRC § 382 generally limits the amount of taxable income of any "new" loss corporation that may be offset by pre-existing NOLs, and certain other tax attributes, in each year following an "ownership change."
  - Ownership Change: Stock owned by 5-percent shareholders increases by more than 50 percentage points over lowest percentage of stock owned by those 5-percent shareholders over testing period (3 years unless there was an ownership change during that period or the company was not a "loss corporation" for the entire period).
- Subject to certain adjustments and two bankruptcy exceptions, the IRC § 382 limitation equals (1) the value of the old loss corporation under § 382(e) (i.e., the value of the stock immediately before the ownership change – which is typically near zero in a bankruptcy context), multiplied by (2) the long-term tax-exempt rate.
  - If the new loss corporation does not continue the business enterprise of the old loss corporation for two years following an ownership change, the § 382 limitation generally will be zero.

Share-for-share exchange in Luxembourg

- Conditions
  - Tax neutral exchange applies to:
    1. company conversion;
    2. share exchange in merger or demerger; and
    3. share exchange with EU or similar companies where acquirer gets or increases majority of voting rights
  - Option for taxation is possible in (ii) and (iii)
- 10% Cash payment
  - Non-taxable cash payment up to 10% of nominal value of exchanged shares
- Valuation
  - For the shareholder, the cost and acquisition date of the shares received in exchange match the cost and acquisition date of the shares given in exchange. If the partner receives a cash payment, the cost of the shares received in exchange is reduced by the amount of the payment.

Germany – Relief from Debt (1/2)

Cancellation by third party lender

- Generally taxable income on the level of the borrower
- Tax exemption under Sec. 3a Income Tax Act, Sec. 7b Trade Tax Act for so-called restructuring profits (*Sanierungsgewinn*)
  - Restructuring income is tax exempt and restructuring expenses are non-deductible
  - Reflief from debt (*Schuldenerlass*), in particular cancellation of debt, qualified subordination of debt, debt-buy-back, debt-equity-swap
  - Both before and during insolvency / bankruptcy proceedings applicable
  - Requires need for restructuring (*Sanierungsbedürftigkeit*capability for restructuring (*Sanierungsfähigkeit*), suitability of relief for restructuring (*Sanierungseignung*); intention of restructuring (*Sanierungsabsicht*)
  - Before tax exemption is granted, amount is set-off inter alia against current losses, loss carry-forwards, interest carry-forwards

Germany – Relief from Debt (2/2)

Cancellation by shareholder/related party lender

- If third party would also take such restructuring measure
  - On the level of the borrower same as measure taken by third party
  - But on the level of the lender non-deduction rule of Sec. 8b para. 3 sen. 4-8 Corporate Income Tax Act; escape might be possible if a third party would have issued the loan under comparable circumstances.
- If caused by shareholder relationship
  - On the level of the borrower taxable income to the extent claim is not valuable

    Exemption rule for restructuring profits not applicable

    Taxable income may only be set-off against losses within the restrictions of the minimum taxation rules in Sec. 10d Income Tax Act (EUR 1m fully set-off against loss carry-forwards; only 60% (amendment to 75% planned) of the amount exceeding EUR 1m can be set-off against loss carry-forwards)
  - On the level of borrower generally tax-neutral contribution to the extent claim is valuable but exemption rule Sec. 8 para. 3 se. 4-6 Corporate Income Tax Act if deduction on level of shareholder
  - Risk of dual burden: On the level of the lender expense to the extent the claim is not valuable, but non-deduction rule of Sec. 8b para. 3 sen. 4-8 Corporate Income Tax Act for related parties

Granting a debt waiver in Luxembourg

- General rule
  - Debt waivers are taxable income for the beneficiary company
- Exemption
  - Debt waivers are tax-free up to the amount of taxable income (including carried forward losses) if they aim to restore the financial situation of the beneficiary (e.g. to avoid insolvency).
- Exemption limitation
  - Such exemption does not apply if (i) the beneficiary still has losses after the waiver and (ii) the debt waiver income reduces the losses carried forward
- In an intragroup context
  - Waivers by shareholders are hidden capital contributions up to the going concern value of the debt, which do not affect the profit and loss account for that part.
- Debt-equity swap
  - In a debt-for-equity swap, debt is converted into equity (or similar) instruments, such as (preferred) shares or bonds with warrants attached. Any gain realized (in case of discrepancy in value upon the exchange) is taxable.

Granting a debt waiver in the Netherlands (1/3)

- General rule for debt waivers
  - Taxable income for the debtor
  - However, an exemption from Dutch corporate income tax is applicable for the debtor by means of the waiver profit exemption under the following conditions:
    - The debt is not collectible,
    - The creditor consciously waives its rights under the debt, and
    - The waiver profit is only exempt insofar it exceeds the available tax losses
  - Pressure point for application of waiver profit exemption in conjunction with restrictions on tax loss compensation

Granting a debt waiver in the Netherlands (2/3)

- Waivers by the (direct or indirect) shareholders
  - If it is an at arm's length debt waiver, it is a taxable debt waiver
  - If it is not an at arm's length debt waiver but driven by shareholder motives, the debt waiver is seen as a capital contribution into the subsidiary.
    - Such debt waiver would in principle not be taxable for the debtor subsidiary due to the treatment as capital contribution, BUT be aware of the TP mismatch rules
    - If the creditor takes a tax-deductible loss for the debt waiver, the TP mismatch rules hold that the debt waiver is taxable for the debtor subsidiary
    - Due to the imperfect wording of the TP mismatch rules, the scope can be broader than what it should be based on purpose and intent. These rules were introduced per 1 January 2022 and have not been fully crystallized yet.

Granting a debt waiver in the Netherlands (3/3)

- Waivers by the (direct or indirect) subsidiary
  - If it is an at arm's length debt waiver, it is a taxable debt waiver for the debtor and in principle tax deductible for the creditor => no dividend withholding tax
  - If it is not an at arm's length debt waiver but driven by group relationships, the debt waiver by the subsidiary is seen as a deemed dividend distribution by the subsidiary
    - Not tax deductible for the creditor subsidiary
    - The deemed dividend distribution could be subject to 15% dividend withholding tax. If the (direct) shareholder holds at least 5% of the shares in the creditor subsidiary (and meets other conditions), the dividend withholding tax exemption may apply.

Granting a debt waiver in the UK (1/2)

Corporation Tax

- Basic rule for loan relationships: tax follows the accounts so if a waiver gives rise to an accounting credit prima facie that is taxable income
- However, this is subject to a number of exceptions of which the four most commonly encountered in restructurings are:
  - Where the lender and borrower are "connected" (a common control test) in the relevant accounting period. In such circumstances any credit arising to the borrower is not taxed and any debit arising to the lender is not deductible;
  - Where the borrower meets an insolvency condition;
  - Where the debt is released in consideration for the issue of ordinary shares in the borrower; and
  - Where it is reasonable to assume that, without the release and any arrangements of which the release forms part, there would be a material risk that at some point in the next 12 months the company would be unable to pay its debts.
- There is an equivalent exception to the fourth of these for credits arising where a company's debt is modified or replaced and that amounts to a substantial modification for accounting purposes.

Granting a debt waiver in the UK (2/2)

Deemed releases

- If a group company acquires debt owed by another group company from a third party for consideration less than the carrying value of the debt in the borrower's accounts, the difference is deemed to be released (and the connected companies exception does not apply to it)
- Subject to the "equity-for-debt" exception where:
  - the acquisition is an arm's length transaction; and
  - the consideration given is ordinary capital in the acquiring company (or a connected company); and
- The "corporate rescue" exception where:
  - the acquisition is an arm's length transaction;
  - there is a waiver of at least some of the debt within 60 days; and
  - it is reasonable to assume that, without the release and any arrangements of which the release forms part, there would be a material risk that at some point in the next 12 months the company would be unable to pay its debts.

Granting a debt waiver in Italy (1/2)

- General rule for debt waivers
  - Debt waivers are taxable income for the beneficiary company
- Debt waivers by shareholders and debt-equity swap
  - Debt waivers by shareholders are taxable for the difference (if any) between the face value of the receivable and its tax cost for the shareholder, irrespective of the accounting treatment
  - The same rule applies to creditors that become shareholders upon conversion of their receivable into equity (or equity-like financial instruments) of the beneficiary company
  - The tax basis of the receivable must be self-declared by the creditor, otherwise it is deemed to be nil. For non-Italian creditors, the tax cost of the receivable in their residence State shall be considered
  - The tax value of the equity in the beneficiary company is increased by (or in case of debt-equity swap is equal to) the amount of the tax value of the waived receivable
- Debt waivers in the context of insolvency procedures
  - Debt waivers in the context of insolvency procedures leading to the dissolution of the beneficiary company (e.g. liquidation) are not taxable income
  - Debt waivers in the context of insolvency procedures leading to the rehabilitation of the beneficiary company (e.g. debt restructuring agreement) result in a reduction of the tax attributes of the beneficiary company

Granting a debt waiver in Italy (2/2)

- WHT on deemed interest payment
  - Under the so-called “juridical payment” doctrine, debt waivers should trigger the application by the beneficiary company of the WHT on any interest accrued on the debt but not yet paid upon waiver
- Debt modification
  - If the renegotiation results in the derecognition of the original financial liability (substantial modification under applicable accounting principles), any income accounted for by the beneficiary company is taxable according to the rules applicable to debt waivers
  - If the renegotiation does not result in the derecognition of the original financial liability, any income accounted for by the beneficiary company (one-day profit) is taxable as interest income

Granting a debt waiver in Switzerland (1/3)

Corporate Income Tax

- General rule for debt waivers
  - Taxable income for the beneficiary company (set-off against NOLs; extension of the 7-year limitation for recapitalizations)
- Waivers by the (direct or indirect) shareholders
  - in principle also taxable income (independent from the accounting treatment; but the administrative practice may change); for the shareholder tax deductible
  - Exceptionally, capital contributions not subject to CIT (and for the shareholder not tax deductible) if and to the extent that:
    - the loan had been classified as deemed equity under the thin cap rules
    - the shareholder had granted the loan when the borrower was already in financial distress
- Waivers by other affiliate entities
  - If the waiver is at arm's length: taxable income; for the affiliate entity tax deductible
  - If the waiver was not at arm's length: capital contribution; for the affiliate entity not tax deductible

Granting a debt waiver in Switzerland (2/3)

1% Issuance Stamp Duty

- Waivers by the (direct or indirect) shareholders
  - 1% issuance stamp duty irrespective of the treatment of the waiver for CIT purposes.
  - Exceptions:
    - No stamp duty on the waivers of up to CHF 10m
    - Waiver of the stamp duty upon request if and to the extent that the borrower uses the waiver as recapitalization
    - No stamp duty on waivers by indirect shareholders
  - To the extent that the company accounts for the waiver (if from the direct shareholder) as equity: classification as so-called “reserves from capital contributions” for dividend withholding tax purposes
- Waivers by other affiliate entities
  - No stamp duty

Granting a debt waiver in Switzerland (3/3)

35% Dividend withholding tax

- Waivers by the (direct or indirect) shareholders
  - No dividend withholding tax
- Waivers by other affiliate entities
  - If the waiver is at arm's length: for the affiliate entity income tax deductible => no dividend withholding tax
  - If the waiver was not at arm's length:
    - for the affiliate entity not tax deductible => 35% dividend withholding tax
    - The parent company of the borrower is treated as the recipient of the deemed dividend distribution (and thus entitled to the refund of the withholding tax to the extent eligible)

U.S. – Ownership Change Limitation on Attributes

- IRC § 382(l)(5) - the § 382 limitation shall not apply to any ownership change if:
  - the loss corporation is (immediately before such ownership change) under the jurisdiction of the court in a title 11 or similar case (a receivership, foreclosure, or similar proceeding in a Federal or state court);
  - the transaction resulting in the ownership change is ordered by the court or is pursuant to a plan approved by the court; and
  - the shareholders and "old and cold" creditors of the loss corporation (determined immediately before such ownership change) own (after such ownership change and as a result of being shareholders or creditors immediately before such change) 50% or more of the vote and value of the stock of the new loss corporation (or stock of a controlling corporation if also in bankruptcy).
- If IRC § 382(l)(5) does not apply to an ownership change triggered by a bankruptcy reorganization (or the debtor elects not to apply it), the § 382 limitation will be calculated under IRC § 382(l)(6).
  - Subject to various rules and exceptions, under IRC § 382(l)(6) the value of the loss corporation is the lesser of the stock value of the loss corporation immediately after the ownership change (calculated to reflect any increase in value resulting from any surrender or cancellation of creditors' claims in the transaction); or the value of the loss corporation's pre-ownership change assets (determined without regard to liabilities).

Carried forward losses in Luxembourg

- General rule
  - Tax losses incurred from 2017 onwards can be carried forward for up to 17 years. Older losses can be carried forward indefinitely. No carry-back is allowed in Luxembourg.
  - Non-taxable cash payment up to 10% of nominal value of exchanged shares
- Abuse of law?
  - The Administrative Tribunal decided on 30 March 2023 that the tax authorities correctly deemed it abusive for a company to use its shareholding losses carried forward to offset a short-term real estate gain from a new activity (real estate management). This relates to LTA Circular LIR n°114/2 of 2 September 2010 and "Mantelkauf" doctrine (i.e. abusive acquisition of a dormant company with no valuable assets but tax losses carryforwards in absence of a same economic identity)
- Loss-making PE
  - Losses of a Luxembourg permanent establishment of a non-resident business can also be carried forward, if the PE has proper accounts. These accounts do not need to be in Luxembourg.

Carry forward and carry back of losses in Germany

- Carry back is currently possible to the two previous years, but limited to EUR 1 million
- Indefinite loss carry forward
  - But taxable income may only be set-off against losses within the restrictions of the minimum taxation rules, i.e. currently EUR 1m fully set-off against loss carry-forwards; only 60% of the amount exceeding EUR 1m can be set-off against loss carry-forwards; amendment to 75% currently under discussion
  - Loss carry forwards cease to exist in case of a direct/indirect acquisition of shares of more than 50% within a five year period by an acquirer or persons related to an acquirer within a five year period.

    Exemption rules:

    (i) intra-group exemption rule

    (ii) built-in gains exemption rule

    (iii) restructuring exemption rule (*Sanierungsklausel*)

    (iv) continuation exemption rule

Carried forward losses in Italy

- General rule
  - Tax losses can be used to offset up to 80% of the taxable income, unless incurred in the first 3 years
  - Tax losses can be carried forward indefinitely. No carry-back is allowed in Italy
- Abuse of law?
  - The change of control of the company triggers the forfeiture of tax losses carried forward if it is accompanied with the change of the company's main business activity either in the tax year in which the change of control occurs or in the 2 preceding/following tax years
  - According to a proposed amendment expected to be approved soon:
    - the change of control within the same group will not trigger the restriction
    - the change of the main business activity of the company will be no longer relevant
  - The company can avoid the forfeiture of tax losses carried forward if a "vitality test" (which takes into account labor costs and revenues of the company) is satisfied or if it obtains a tax ruling from the tax authorities confirming that the transaction is not abusive
- Loss-making PE
  - Losses of an Italian permanent establishment of a non-resident company can be carried forward according to the same rules applicable to Italian companies

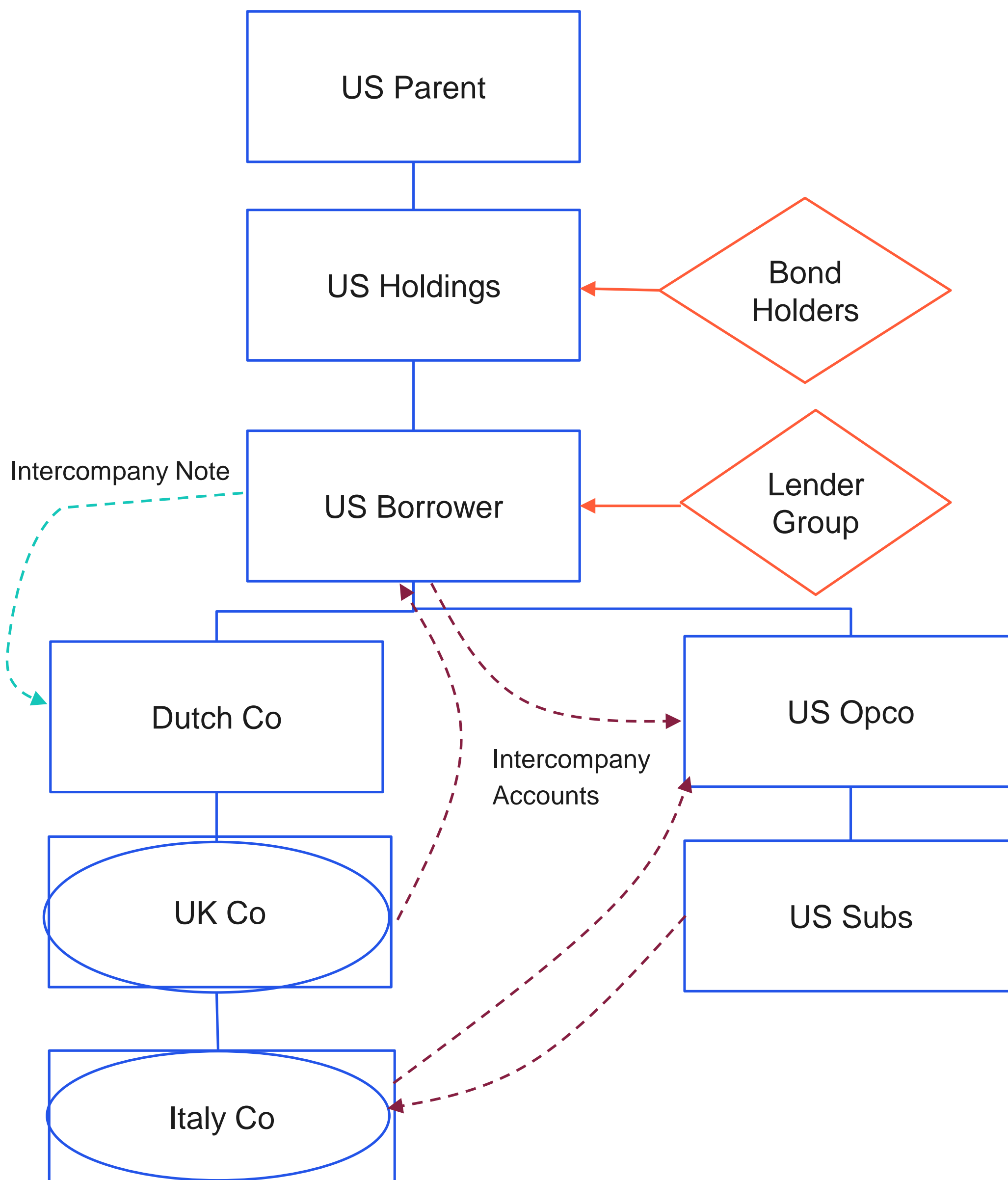
Carried forward losses in Switzerland

- General rule
  - Tax losses can be carried forward for up to 7 years. No carry-back is allowed in Switzerland.
  - The 7-year limitation is extended if and to the extent that the borrower uses the waiver as recapitalization
- Abuse of law?
  - Any transfer of shares does not trigger any cancellation of NOLs of the transferred company
  - The NOLs can be transferred in case of a merger within Switzerland unless if the merging company has already discontinued its business operations
- Loss-making PE
  - A Swiss company can use the losses incurred by a foreign PE for Swiss CIT purposes if that PE cannot use those losses against own profits; but there is a claw-back once the PE can use those losses for its CIT purposes.

Carry forward and carry back of losses in the Netherlands

- From 1 January 2022 onwards, an indefinite loss carry forward applies. Carry back is possible to the previous year.
  - For the carry forward, losses incurred in financial years that started on or after 1 January 2013 also fall under the new rules that apply per 2022.
- For losses (both carry forward and carry back) a restriction applies for the amount that can be used.
  - The losses can only be fully used up to an amount of EUR 1 million taxable profit per year. To the extent that this profit exceeds EUR 1 million, the maximum amount of losses that can be offset is limited to 50% of the taxable profit of the year at stake.
- Loss compensation is in principle not possible if the ultimate interest in the loss company has changed substantially (30% or more). An exception can apply, requiring for loss carry forward among others that the total size of the loss company's activities has not been reduced to less than 30% of the total activities

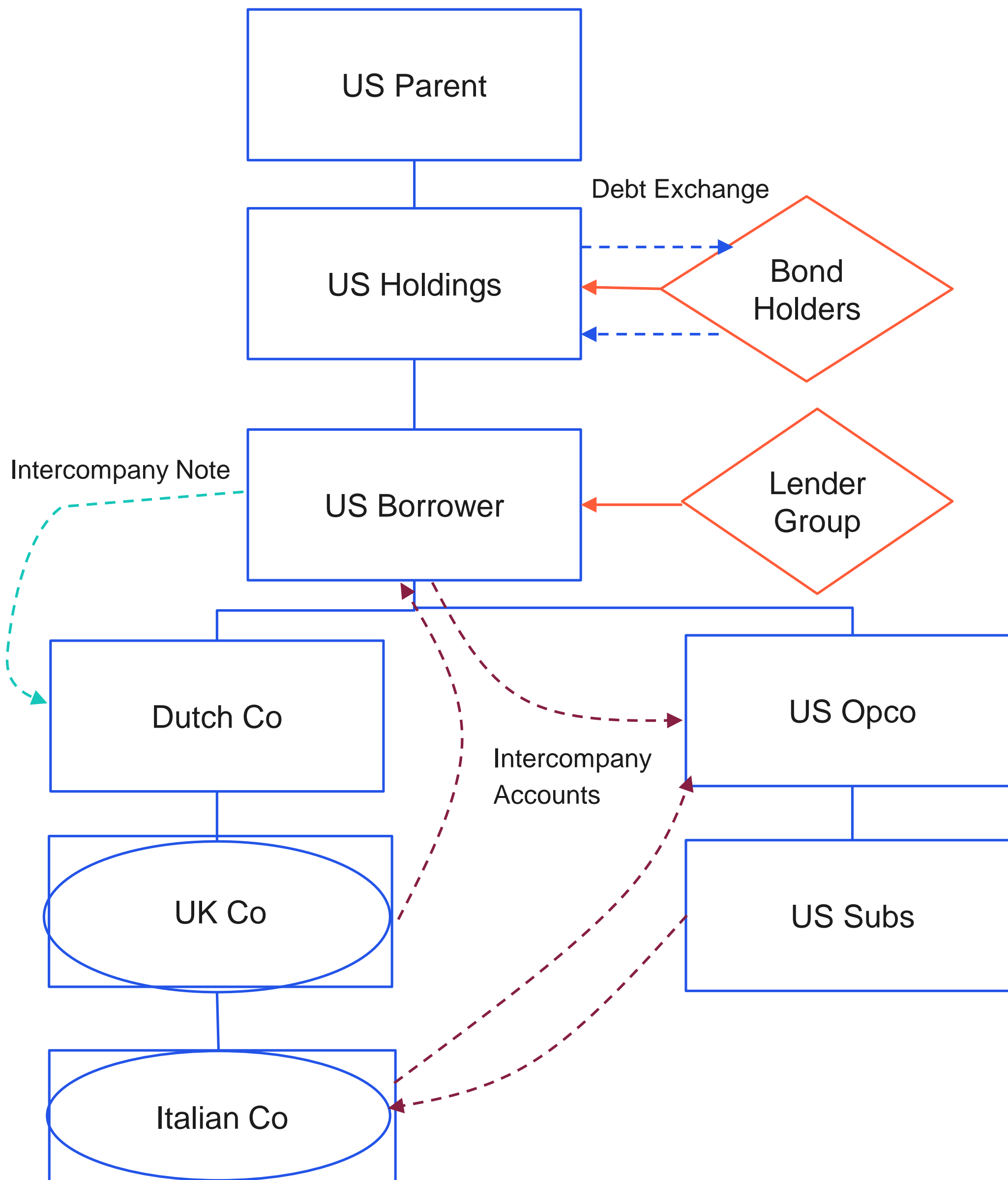
Scenario 1 – US Parented Group



Facts

- US Parent is a US-incorporated C corporation that is suffering from financial distress.
- Its subsidiary, US Holdings, has outstanding unsecured bonds held by a disparate group of third party bondholders. US Parent guarantees the bonds; bond holders are party to an intercreditor agreement with Lender Group subordinating their rights to the rights of the Lender Group on the US Holdings Guarantee.
- US Borrower has an outstanding term loan borrowed from third party Lender Group (a mix of CLOs, banks and private credit) that is backed by a guarantee of US Holdings, and each of the US subsidiaries and secured on a first lien basis by the assets of US Borrower and its US Subs. US Borrower has pledged 65% of the stock of Dutch Co. and the intercompany note.
- The group has a complicated intercompany web that consists of both documented loans and journal entries.
- US Borrower loaned money on a documented intercompany note to Dutch Co. in the past for valid business reasons.
- US Parent and its US Subsidiaries are balance sheet insolvent.

Scenario 1 – US Parented Group (cont'd)



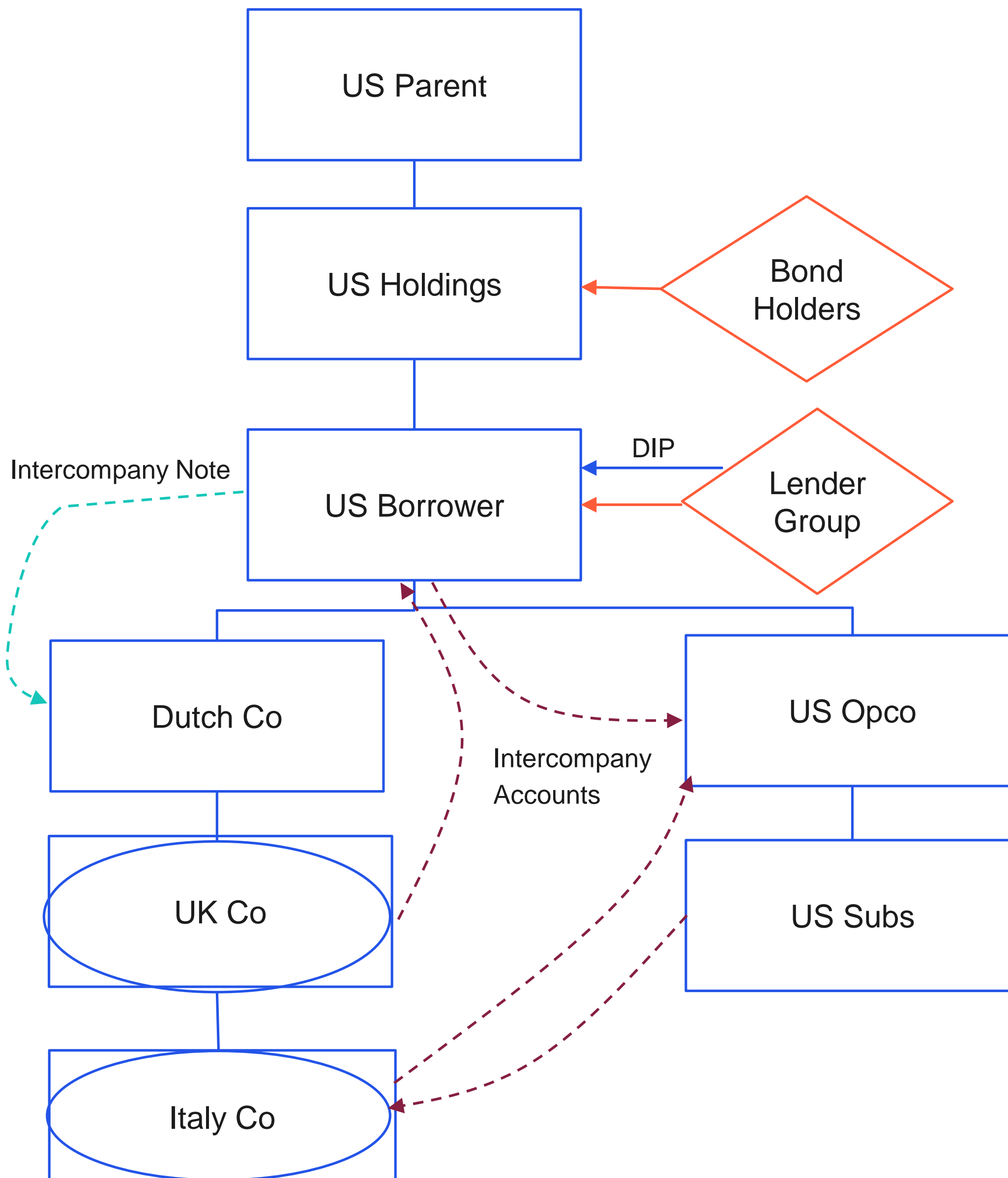
Out-of-Court Alternative:

- US Holdings offers its bondholders an opportunity to exchange their bonds for new bonds that are secured by a second lien on all of the assets of US Holdings and its US subsidiaries (the "Up-Tier Exchange").

Questions:

- Is there US cancellation of indebtedness income ("CODI")?
  - Are trading prices or quotes publicly available for the bonds?
  - Is the Up-Tier exchange a "significant modification" of the bonds?
    - Bright line change in yield test.
    - Safe harbor for change in maturity.
    - Does the addition of security create a change in payment expectations?
    - Difference if bonds exchanged for bonds of US borrower?
- Can that CODI be excluded from taxable income?
  - Only to extent of insolvency, otherwise taxable income
- If the CODI is excluded, then what?
  - Tax attributes reduced (NOLs, tax credits, tax basis, etc.)
- If there are no changes to the intercompany note or intercompany web, any non-US implications?

Scenario 1 – US Parented Group (cont'd)



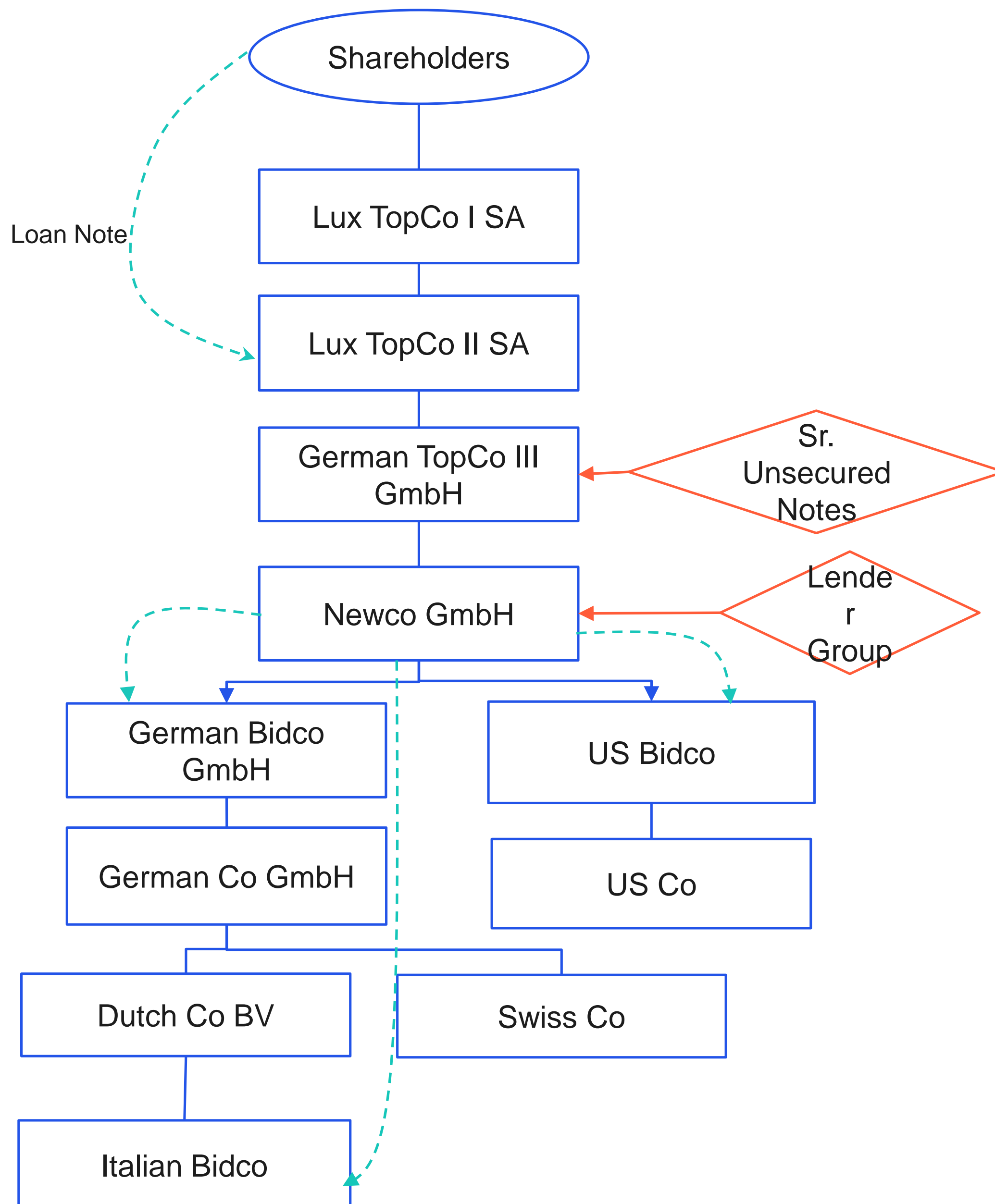
Out-of-Court Alternative:

- US Parent and each of its US subsidiaries file for Chapter 11 Bankruptcy Protection.
- In connection therewith Lender Group provides a super-priority debtor-in-possession ("DIP") facility, which is supported in part by a guarantee by Dutch Co, UK Co and Italian Co.
- Upon emergency from bankruptcy, Lender Group rolls the DIP into an exit facility and receives 90% of the FD equity of US Parent, representing a recovery of of 75%. Bondholders receive warrants to purchase 5% of the FD equity at a negotiated strike price. Remaining 5% reserved for management plan.
- As part of the emergence transactions, the group's intercompany web is settled.

Questions & Observations:

- Any impact of recognition of Chapter 11?
- How much US CODI/taxable income does the group have?
  - Valuation questions.
  - Intercompany resolution must be considered.
- CODI can be excluded in full, subject to attribute reduction.
- US Parent will have an "ownership change" for US tax purposes under Section 382, limiting US Parent's NOL carryforwards.
  - Special rules for taxpayers in Chapter 11 proceedings.
- The manner in which intercompany accounts is resolved can be crucial.
  - Contribution to capital v. contribution in exchange for equity.
  - Solvency of entities matters.

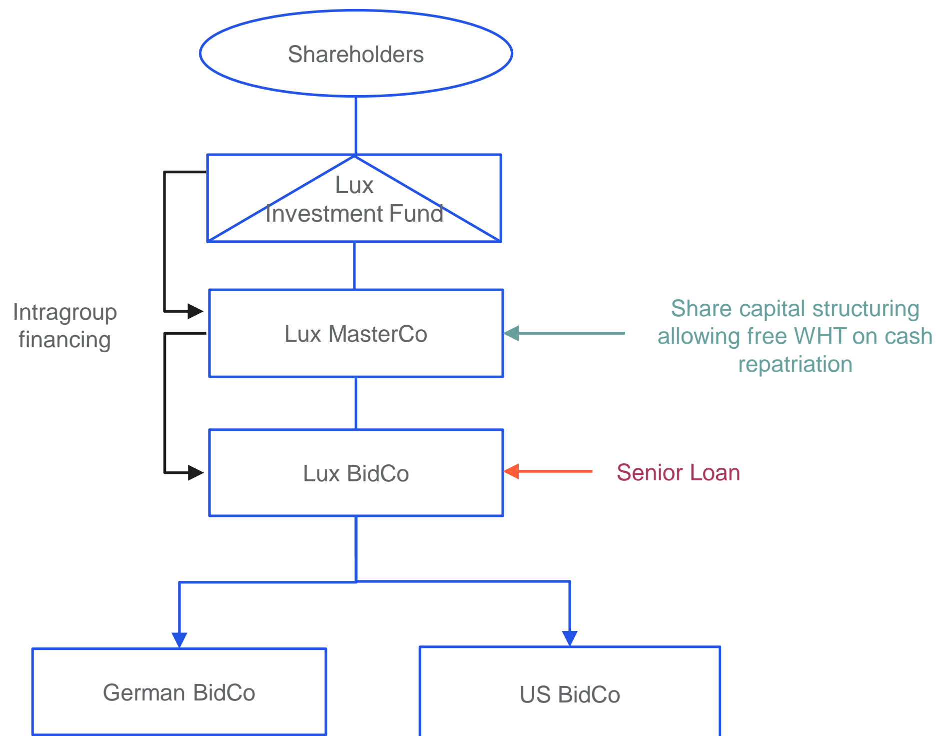
Scenario 2 – Luxembourg Parented Group



Facts:

- Shareholders established structure to acquire the equity of German Co and US Co.
- They capitalized Lux TopCo I entirely with equity, and Lux TopCo II in part with an instrument treated as debt for Luxembourg purposes.
- German TopCo III borrowed Senior Unsecured Notes from unrelated third parties and contributed the proceeds to Newco GmbH.
- Newco GmbH borrowed for an unrelated third party lender group. It financed German Bidco and US Bidco in part with debt and in part with equity. Both the US and German subsidiaries provide credit support for the Lender Group loans.
- At a later point NewCo GmbH made an intercompany Loan to Italian Bidco for the acquisition of Italian assets
- Like the prior example there is a complex intercompany web (not shown).
- The group is now financially troubled, and US Co separately has a substantial tort liability.

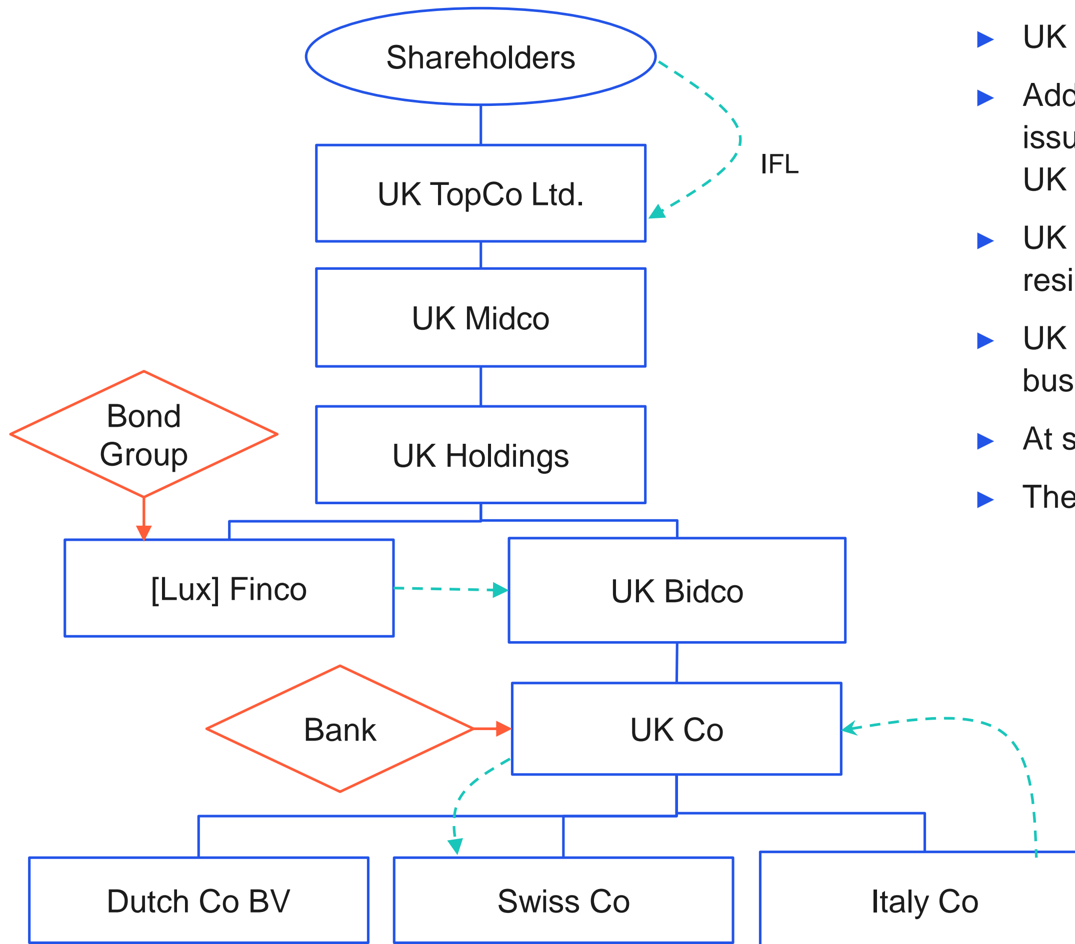
Scenario 2b - Luxembourg Parented Group



Facts:

- Shareholders established in the EU or outside the EU invest equity in Lux Investment Fund (opaque or transparent).
- MasterCo as national investment platform, can ensure minimum substance requirements.
- Lux BidCo as dedicated vehicle holding foreign SPVs silo, with access to double tax treaties.
- Debt-equity swap: Senior Loan could be contributed as equity in Lux BidCo. Senior Lender would become shareholders of the structure.
- Debt-waiver: Lux entities (Lux MasterCo; LuxBidCo) could receive debt-waivers granted by other related entities within the group or by third parties.

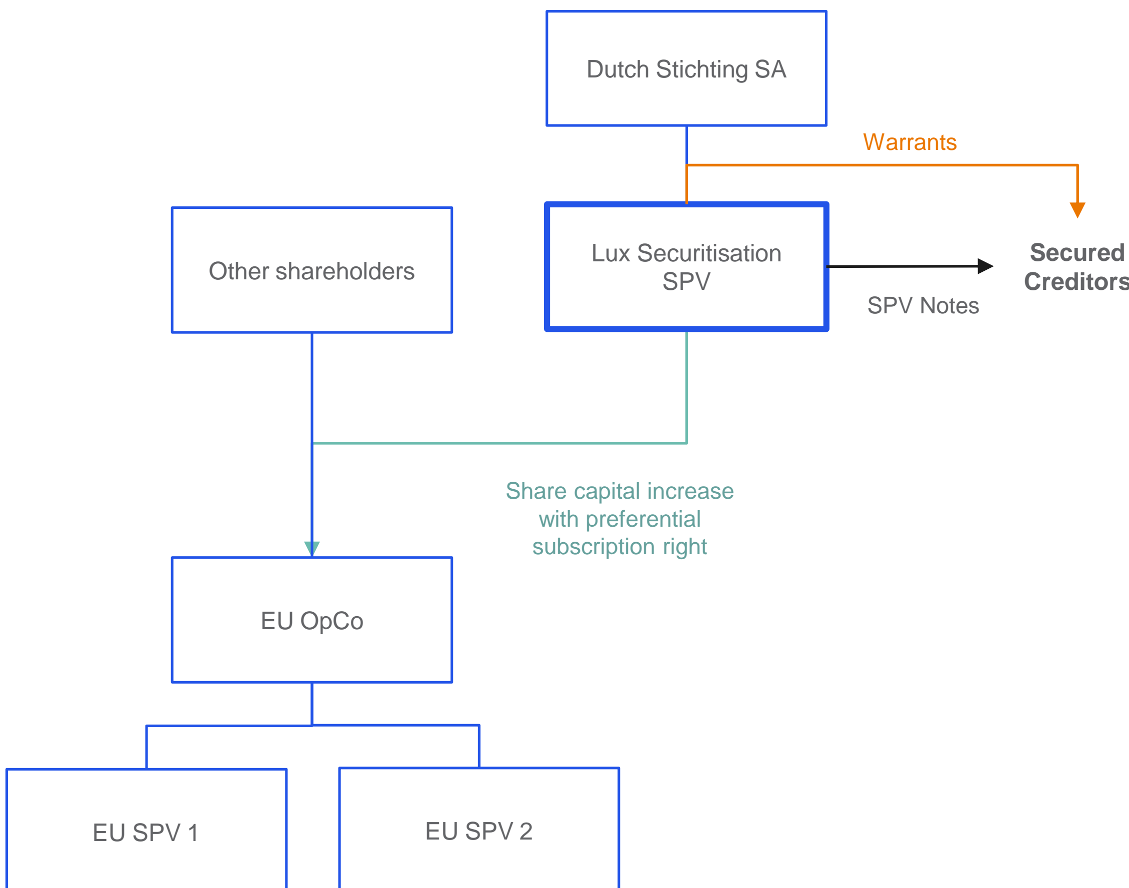
Scenario 3 – UK Parented Group



Facts:

- UK Topco capitalized with equity and interest free loans.
- Additional financing provided by a Luxembourg Finco that issued bonds to the public and on-loaned the proceeds to UK BidCo.
- UK Co. also borrowed under a term loan from a UK resident bank.
- UK Co. on-loaned some funds to Swiss Co. for good business reasons.
- At some point Italy Co made an upstream loan to UK Co.
- The group is now financially troubled

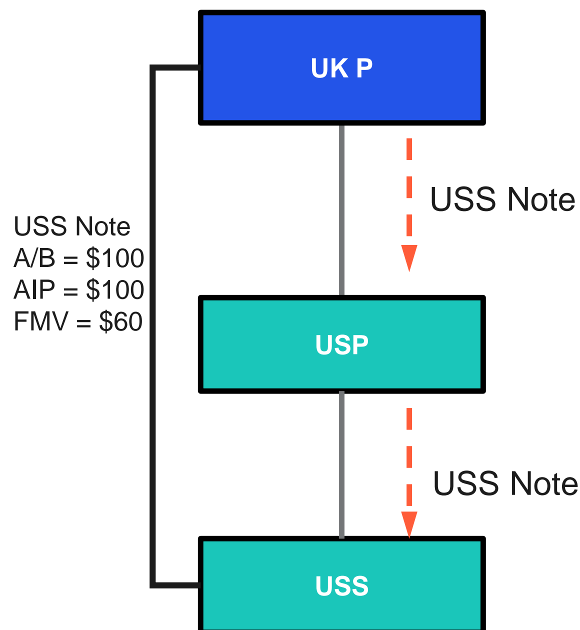
Scenario 4 –Luxembourg as a Debt Restructuring Platform



Facts:

- EU OpCo is a European company in collective proceedings and subject to a safeguard plan, where creditors should switch their right to equity.
- Lux Securitisation SPV is an orphan investment vehicle subject to Luxembourg securitisation law.
- Secured Creditors contribute their EU OpCo receivables to the Lux Securitisation SPV and hold only debt instruments (i.e. SPV Notes / Warrants), not equity (for regulatory reasons).
- Lux Securitisation SPV will sell its shares in EU OpCo after 2 years according to the Safeguard plan of EU OpCo and the Secure Creditors would receive the proceeds under the debt instruments issued by the Lux Securitisation SPV.

Intercompany Debt Examples



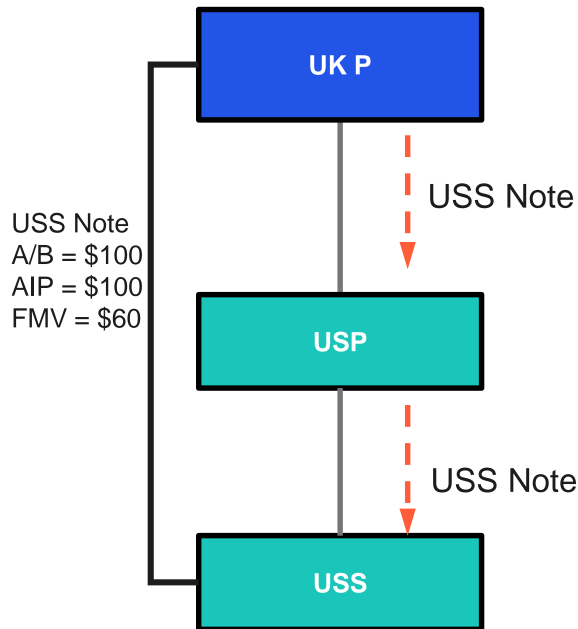
Facts:

- UK P owns USP, the parent of a US consolidated group that includes USS.
- UK P previously lent money to USS in exchange for the USS Note.
- The USP consolidated group is struggling financially, and UK P contributes the USS Note to USP, which contributes the USS Note to USS (resulting in its cancellation).

Expected consequences:

1. The USS Note becomes an intercompany obligation on the contribution from FP to USP.
2. Pursuant to Treas. Reg. 1.1502-13(g)(5), USS is treated as satisfying the USS Note with $60 of cash.
   1. USS realizes $40 of CODI.
   2. Pursuant to IRC Section 362(e)(1), USP is expected to take the USS Note with a FMV ($60) basis, and USP would not have any gain or loss on the deemed satisfaction of the USS Note.

Intercompany Debt Examples (cont’d)



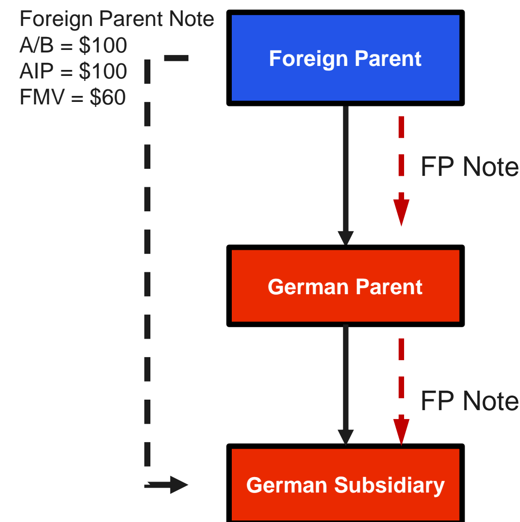
Expected consequences (cont.):

3. USP is then treated as transferring $60 to USS in exchange for a “new” USS Note.
4. No further amounts realized on contribution of the “new” USS Note (A/B of $60) by USP to USS.

Potential Alternatives?

1. Contribution of additional funds by FP to USP (and then USS) then used by USS to repay the USS Note. Circular?
2. Direct contribution of the Note by FP to USS for USS stock (with the USS stock then contributed by FP to USP) is subject to IRC Section 108(e)(8) in form (with CODI realized).
3. USP assumes sole liability on the Note from USS, and FP then contributes the Note to USP.
   a) Expected to constitute a significant modification (see Treas. Reg. Section 1.1001-3(e)(4)(i)).
   b) Significant modification may not itself result in CODI.
   c) However, respected if FP plans to contribute the indebtedness to USP (no intent to repay)?

Intercompany Debt Examples - Germany



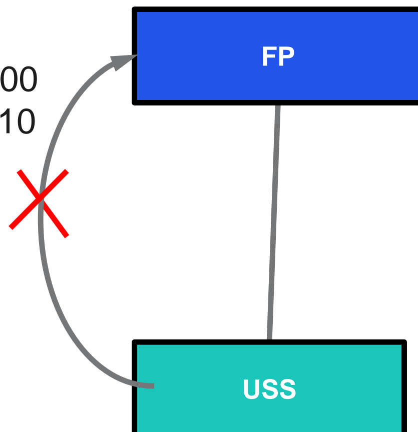
► Contribution of the Foreign Parent (FP) Note to German Parent (GP) and German Subsidiary (GS)

Contribution to GP at fair market value ($ 60); contribution by GP to GS triggers taxable income on level of GS to the extent claim is not fully valuable ($ 40)

► Potential Alternatives

1. Contribution of additional funds by FP to GP and then GS; then used by GS to repay the FP Note: Should be covered by the general principle of the freedom of financing (*Finanzierungsfreiheit*), but tax authorities might try to apply GAAR
2. Direct contribution of the Note by FP to GS for shares (with the shares then contributed by FP to GP): Triggers taxable income on the level of GS to the extent claim is not fully valuable ($ 40)
3. GP assumes sole liability on the Note from GS, and FP then contributes the Note to GP: Assumption of debt should be neutral, but contribution triggers taxable income on the level of GP to the extent claim is not fully valuable ($ 40); in addition, it needs to be safeguarded that contribution does not reduce income of shareholder; otherwise contribution ($ 60) is not tax neutral on level of GP

Intercompany Debt – Potential Withholding?



Facts:

1. FP originally lent $100 to USS for a Note.
2. At a time at which USS owes FP $100 of principal and $10 of interest, FP cancels the full $110 of obligation owed by USS. No stock of USS is issued. There is no triggering of a withholding obligation before the cancellation.

Question: Does the contribution of the $10 of accrued interest to USS result in a deemed payment subject to withholding?

Analysis:

- Under IRC Section 108(e)(6), Congress appears to have chosen to have the contributee corporation realize COD income (to the extent the shareholder has not already reported the income and generated basis in the liability), and not by shareholder
- Creating a deemed payment from USS to FP for the interest liability would appear contrary to intent of IRC Section 108(e)(6).

Waiver profit exemption & tax loss compensation - Netherlands

- Pressure point for application of waiver profit exemption in conjunction with restriction on tax loss compensation
  - If the debtor company has available tax losses but cannot use all the losses in a given year due to the restriction on tax loss compensation, while the debt waiver exceeds the amount of tax losses that can be offset in that year, Dutch corporate income tax will be due on part of the debt waiver
  - Appears to be contrary to the purpose and intent of the waiver profit exemption and can hinder restructurings
  - Recent debates in the Netherlands with request to fix this issue by changing the existing rules, e.g. by disregarding the restriction on tax loss compensation in case of debt waiver profits.
  - The Dutch Ministry of Finance is assessing the possibilities and it is expected that they have further information in Q1 2024

Waiver profit exemption & tax loss compensation - Netherlands

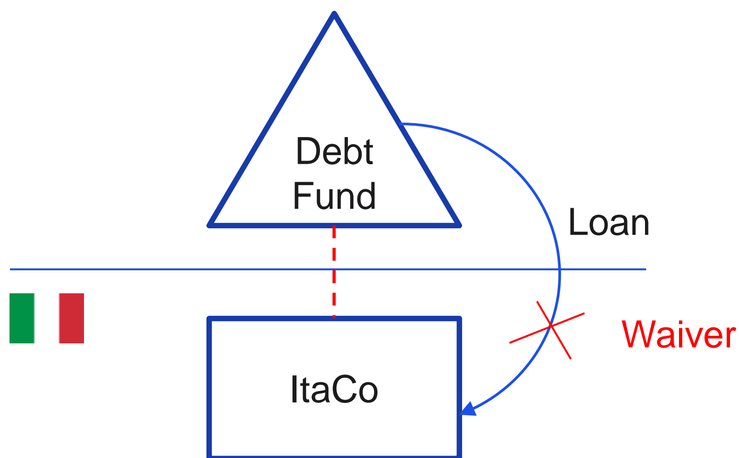
Example

Waiver profit	€ 7 million
NOLs available	-/- € 5 million
Waiver profit exemption	-/- € 2 million
Taxable profit	€ 5 million
Loss compensation	-/- € 3 million
Taxable amount	**€ 2 million**

=> loss compensation restriction:

- € 1 million franchise +
- € 2 million (50% of (taxable profit -/- franchise))

Debt–equity swap - Example - Italy



Facts:

1. A non-Italian debt fund purchased a loan receivable of EUR 11m (EUR 10m principal + EUR 1m accrued interest) *vis-à-vis* ItaCo at a price of EUR 8m
2. ItaCo is in financial troubles; the debt fund agrees to convert its credit into equity of ItaCo
3. ItaCo has tax losses carried forward of EUR 5m

Analysis:

- ItaCo recognizes taxable income equal to EUR 3m (i.e., EUR 11m – EUR 8m), assuming EUR 8m is the tax value of the receivable
- The tax value of the equity in ItaCo of the debt fund for future capital gain purposes is equal to EUR 8m (i.e. the tax value of the waived receivable)
- If the waiver occurred in the context of a debt restructuring agreement, ItaCo would not recognize any taxable income, but the waiver would result in a reduction of its tax losses carried forward by EUR 3m
- Does the waiver of the EUR 1m of accrued interest result in a deemed payment subject to WHT?