

REPORT #728

TAX SECTION

New York State Bar Association

Letter in Opposition

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July 16, 1992

The Honorable Dan Rostenkowski
 Chairman
 Committee on Ways and Means
 2111 Rayburn House Office Building
 Washington, D.C. 20515

Dear Mr. Chairman:

We urge that the proposal by Rep. Guy Vander Jagt to repeal the so-called "stock-for-debt exception" to the recognition of cancellation of debt income be rejected by the House of Representatives or, if possible, immediately withdrawn.

The repeal of the stock-for-debt exception would make it more expensive for financially troubled corporations to restructure their debt, further hindering the economic recovery of such corporations. It would encourage liquidating rather than reorganizing financially distressed or overleveraged businesses, resulting in significant job losses. This appears counterproductive at a time when the country is trying to emerge from its worst recession in the last 50 years.

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The proposed repeal of the stock-for-debt exception raises conflicting policies between the bankruptcy laws and the tax laws. These conflicting policies were carefully considered by Congress when it enacted the Bankruptcy Reform Act of 1978 and the Bankruptcy Tax Act of 1980, which not only retained the stock-for-debt exception for federal income tax purposes, but mandated its application for state and local tax purposes (see section 346(j)(7) of the Bankruptcy Code). Although the Treasury Department may have initially questioned the basis for the stock-for-debt exception, the Treasury Department ultimately supported the retention of the stock-for-debt exception in the Bankruptcy Tax Act of 1980 as part of an overall compromise, and an appropriate balancing, of competing bankruptcy and tax policies.

Given this background and the current economic situation, it seems to us particularly egregious that such an important and basic change in the area of bankruptcy tax policy would be undertaken without prior study, and without the benefit of public hearings and discussions (including consultation with the Judiciary Committees of the Congress and the Bankruptcy bar), and would be submitted to a floor vote in the form of a noncontroversial "revenue raiser".

We note that this proposal is just the latest in a number of tax changes since the adoption of the Bankruptcy Reform Act of 1978 and the Bankruptcy Tax Act of 1980 that have made the survival of financially troubled and overleveraged companies more difficult and thus have been contrary to the policies of both these Acts. In fact, we cautioned against similar precipitous action in 1990 when Congress was considering legislation requiring the recognition of cancellation of debt income in debt-for-debt exchanges of equal face amounts, and repealing the stock-for-debt exception for exchanges of preferred stock for debt. Ultimately, that legislation was adopted. Since that time, however, Treasury has had an opportunity to reflect on that legislation and is currently reconsidering the prudence of such legislation, at least with respect to debt-for-debt exchanges. Moreover, Rep. Moody recently introduced a bill (HR 3262) that would reinstate the prior law with respect to debt-for-debt exchanges with certain modifications.*

Accordingly, as we did then, we urge Congress and the Treasury to undertake -- and would be glad to assist in -- a study designed to bring the policies of the tax law and the bankruptcy law into greater harmony. To this end, the group

* Such bill appears to be consistent with the prior position of the Tax Section. See Report of the Ad-Hoc Committee on Provisions of the Revenue Reconciliation Act of 1990 Affecting Debt-for-Debt Exchanges, Tax Notes, dated April 8, 1991, at p. 79.

conducting the study should include United States Bankruptcy Court judges and others experienced in bankruptcy matters.

Thus, we urge Congress against taking any precipitous action to repeal the stock-for-debt exception, which repeal will have disastrous effects on many corporations struggling to reorganize and make an already dire economic situation worse.

Very truly yours,

John A. Corry
Chair

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