

**REPORT #765**

**TAX SECTION**

**New York State Bar Association**

Report on Repeal of the Stock-for-Debt

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# TAX SECTION

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June 23, 1993

Via Federal Express

The Honorable Daniel P. Moynihan  
Chairman  
Finance Committee  
United States Senate  
Washington, D.C. 20510

Re: Repeal of the Stock-for-Debt Exception

Dear Mr. Chairman:

On June 11, 1993 the Tax Section submitted a letter with attached reports dealing with certain provisions of the Revenue Reconciliation Bill of 1993 as reported by the House of Representatives. There-after, the Senate Finance Committee reported a revised version of that Bill which departs in a number of significant respects from the House Bill. On behalf of the Tax Section I am writing to express our concern about a provision in the Senate Bill that would repeal the "Stock-for-Debt Exception" from cancellation of indebtedness income, generally effective with respect to transactions taking place after June 16, 1993.

One year ago a similar proposal was made in the House. We objected then, and we object now, to the serious procedural deficiencies of this kind of piecemeal approach

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to lawmaking. The Stock-for-Debt Exception involves complex considerations of both tax and bankruptcy policy. The Tax Section strongly believes that there must be full and considered review, including public hearings, of the tax and bankruptcy policies affected by the Stock-for-Debt Exception prior to any repeal of that exception. QQ See our letter of June 16th, 1992, a copy of which BBSS is attached.

While we certainly appreciate the tax policy and simplification arguments which may be made in favor of the repeal, we also strongly believe that the contrary position deserves to be articulated and heard. Congress gave full consideration to the merits and demerits of the exception in its consideration of the Bankruptcy Tax Act of 1980. While the exception has been affected by subsequent legislative enactments, it remains an important feature of bankruptcy tax planning.

Repeal or retention of the exemption affects not only the tax system but also the bankruptcy system. Given the important and unique role of the Federal Government in the bankruptcy area, careful consideration should be given to the effects of this change on bankrupt companies, their lenders and other constituencies. In particular, if repeal were determined to be sensible from a tax policy standpoint, consideration should be given to alternative means to replace the benefit accorded by this exception to bankrupt companies in a manner which reconciles affected tax and bankruptcy policies in a reasonable way. None of this can be achieved when the repeal takes the form of a last-minute insertion in a pending bill, without the benefit of hearings and public discussion. For these reasons, we reiterate the views reflected in our July 16, 1992, letter. We would be happy to work with the Congressional and Treasury Department staffs to come up with a balanced solution to the problems in this area.

Yours truly,

Peter C. Canellos

attachment

cc: Dan Rostenkowski  
Chair  
House Ways & Means Committee

Don Longano  
Chief Tax Counsel  
House Ways & Means Committee

Joseph Gale  
Chief Tax Counsel  
Senate Finance Committee

Harry L. Gutman  
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June 23, 1993

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

Dear Hr. 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.

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

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Bankruptcy Reform Act of 1978 and the Bankruptcy Tax Act of 1980f 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.\*

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\* 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.

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 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

cc: The Honorable Guy Vander Jagt  
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