



Managing your tax position in a troubled economy

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1. Guard your tax attributes

Attribute limitations and how they might be triggered



Attribute Limitations

- Section 382/383/384
- Separate Return Limitation Year (SRLY) limits
- Basis and passive activity/at-risk limitations (private companies)
- AMT traps

Section 382

- Applies when there is a significant ownership change in a loss corporation
- Ability to use losses is limited
- The amount of the NOLs does not change with Section 382, but the annual limitation may cause some of the NOLs to expire unused
- Section 383 applies similar limit to tax credits and capital loss carryovers



Recognizing a 382 Ownership Change

- For Section 382 purposes, an ownership change occurs when:
 - A significant stock ownership change occurs within the testing period, generally three years
 - Stock percentage held by 5% shareholders increases by more than 50 percentage points
- Examples of ownership shifts that may result in Section 382 limitations:
 - Stock transactions (purchases and sales of shares)
 - Redemptions or issuances of stock
 - Reorganizations



Section 382 Annual Limitation

- For Section 382 purposes, the annual limitation is equal to:
 - “Federal long-term, tax exempt rate” (currently about 4.5%), multiplied by the
 - Value of the loss corporation immediately before the ownership change
- Example:
 - Company with \$20 million of NOLs redeems stock when total Company value is approximately \$40 million
 - Assume this redemption is sufficient to trigger a Section 382 change
 - Section 382 limitation is $\$40 \text{ million} \times 4.5 \% = \$1.8 \text{ million per year}$
 - Company will need at least 12 years to use all NOLs

Separate Return Loss Years (SRLY)

- Losses or credits from a separate return year can only be utilized to the extent that those losses would have been utilized if the member continued to file a separate return.
- Generally arises when companies with common ownership begin filing consolidated returns
 - Often relevant when one company has historically been an S corporation
- Structural planning can often avoid a SRLY limitation!

Basis Limitations

- S corporations and LLCs
 - Losses claimed by the owner cannot exceed the sum of the adjusted basis of his/her ownership interest
 - Exceptions available for certain loans to an S corporation and for a member's share of LLC liabilities
 - Trap for the unwary: LLC liabilities do not automatically provide basis in the same way as partnership liabilities, even though they are generally taxed in the same way
 - “At risk” rules have different application in LLCs and partnerships

AMT Planning

- Trucking companies coming out of NOL position are almost always unpleasantly surprised by alternative minimum tax
- AMT NOLs can only be used to offset 90% of taxable income
- Possible planning remedy: elect out of accelerated tax depreciation (and bonus depreciation) to save those deductions for AMT years
- Also, consider electing straight-line depreciation on new purchases, which results in no AMT adjustment at all



2. Be aware of “disguised” income from debt restructuring



COD Income

- Cancellation of indebtedness (COD) income is generally included in gross income under Section 61
- Key exceptions:
 - Chapter 11
 - Insolvency (only to extent of insolvency)

COD Income

- “Price” of excluding COD from income is “attribute reduction”
 - NOLs
 - Credits
 - Capital loss and other carryovers
 - **Asset basis, including fixed assets**
- Generally NOLs are reduced first
- Election available to reduce fixed asset basis, leaving more NOL available for current use
 - Be wary of AMT!!

COD Income

- It is possible to have a debt modification that triggers COD income without a corresponding income event
- Example:
 - Company's debt is publicly traded (thinly)
 - After a debt modification that results in no income to the Company, debt is traded in the market in a transaction that reflects a substantial change in the yield of the debt
 - Company may have COD income as a result, despite still owing the same amount on its debt

COD Income

- Workouts vs. Chapter 11
 - Debt workout (outside bankruptcy) may result in taxable COD income unless the company is insolvent
 - If the company is insolvent, COD income is nontaxable to the extent of insolvency
 - Once sufficient debt is forgiven to make the company solvent, any additional forgiveness results in taxable income
 - In Chapter 11 bankruptcy, all COD income is nontaxable, subject to several detailed exceptions
 - Note that most “nontaxable” COD income is simply deferred, due to attribute reductions



3. Be aware of bankruptcy tax issues



Basics of Bankruptcy Tax

- Reduction of Tax Attributes
 - If debtor excludes canceled debt from income during bankruptcy, he or she must use the excluded amount to reduce certain “tax attributes”
 - By reducing the tax attributes, the tax on the canceled debt income is postponed instead of being entirely forgiven



Basics of Bankruptcy Tax

- Generally, use the amount of canceled debt to reduce the tax attributes in this order:
 - Net Operating Loss
 - General business credit carryovers
 - Minimum tax credit
 - Capital losses
 - Basis of debtors property
 - Passive activity loss and credit carryovers
 - Foreign tax credit
- Remember the election to reduce asset basis first!



Basics of Bankruptcy Tax

Other Rules:

- If a corporation transfers its stock in satisfaction of indebtedness and the FMV of the stock or interest is less than the indebtedness owed, the corporation has income to the extent of the difference from the cancellation of indebtedness
- The earnings and profits of a corporation do not include income from the discharge of indebtedness to the extent of the amount applied to reduce the basis of the corporation's property



4. Prepare for future tax savings by taking advantage of low valuations



Estate Planning

- Estate tax rate currently at 45% and includes a \$3.5 million exclusion for 2009
- Estate tax is repealed (for now) in full during 2010
- Estate tax set to return to 2001 levels in 2011
 - \$1 million exemption
 - Top rate of 55%
- Obama administration promises changes here – possible that we will end up staying where we are today
- Consider aggressive gifting and other estate planning now, while values are at historic lows
 - GRATs are very popular



S Corporation Conversions

- All trucking companies that qualify should seriously consider S corporation elections – it is a potentially huge permanent tax savings opportunity for the company and its shareholders and/or family
- Provides one level of tax on future earnings
- Maximum estate planning opportunities
- Other income tax planning opportunities that otherwise may not be available
- Depressed stock valuations allow you to make a one-time S corporation election while minimizing the dreaded “built-in gains” tax!



5. Lock in your credits while they are still available



Alternative Fuel Tax Credits

- Credit currently available for the use of alternative fuels
- Credit is \$0.50 per gallon of fuel used
- Credit can be claimed on excise tax return or income tax return
- This is related to the now infamous “black liquor” credit being claimed by paper companies – it may someday be eliminated
- Example: Propane in forklifts



6. Get your cash now!



Cash Tax Savings

- Bonus Depreciation
- Extended Carry Back Opportunities



Bonus Depreciation

- 50-percent of basis deductible in 2009
- 50-percent of basis depreciated under “normal” tax method
- Personal property (under 20-year life), software and qualified leasehold improvements qualify
- Must be acquired and placed in service during 2009



Refund Opportunities

Quick Refunds

- Applied for on Form 4466
- May allow you to claim a refund within several weeks of year end

Carrybacks of NOLs and “specified liability losses”

- Workers compensation losses may be carried back up to 10 years



7. Plan for the future

Bush Tax Cuts Expiring

Major tax provisions set to expire at the end of 2010	
Tax brackets	Top rate reverts from 35% to 39.6% 33% bracket reverts to 36% 28% bracket reverts to 31% 25% bracket reverts to 28% 10% bracket eliminated altogether; included in 15% bracket
Capital gains	15% rate on capital gains would revert to 20%
Dividends	15% rate on dividends would disappear so dividends would be taxed at normal marginal rates up to 39.6%
Marriage penalty	Standard deduction and 15% bracket for married couple would no longer be double the amounts for individuals
Child credit	Reverts from \$1,000 to \$500
Estate tax	After one year of full repeal in 2010, the estate tax would return to 2001 levels with only a \$1 million exemption and a top rate of 55%



Why it could happen:

The 2008 Election Before & After

- President
 - George W. Bush (R)
- House of Representatives
 - 233 to 202 (D)
- Senate
 - 49 Democrats
 - 2 Ind. (vote w/ D's)
 - 49 Republicans
- President
 - Barak Obama (D)
- House of Representatives
 - 256 to 178 (D)
- Senate
 - 57 Democrats
 - 2 Ind. (vote w/ D's)
 - 40 Republicans



Obama's Budget Proposals

Keep in mind

- They are proposals – not law
- Most of the proposals are not new
 - Campaign proposals
 - Extension of ARRTA proposals
- Many changes are not effective until 2011



Obama's Budget Proposals

Individual Taxes

- Tax Rates
 - Marginal rates preserved below \$200,000/\$250,000 threshold
 - Marginal rates return to pre-Bush levels above the threshold in 2011 (Bush cuts allowed to expire)
 - Capital gains/dividends return to 20% above threshold
- Itemized deductions if AGI above threshold
 - Pease adjustment restored
 - Tax benefit limited to 28% rate
- Perpetual patch proposed for AMT
- Estate taxes frozen at 2009 levels



Obama's Budget Proposals

Individual Taxes

- Stimulus extenders made permanent
 - Make work pay credit
 - Increased tuition credit
- Expanded Saver's Credit
 - 50% match for first \$1,000 if AGI below \$75,000(?)
- Carried interest taxed as ordinary (earned?) income
 - May apply to all partnerships and arrangements
 - Real estate
 - Oil and gas
 - Other “sweat equity” ownership
 - Proposed to be effective 2011



Obama's Budget Proposals

Business Taxes

- Make research credit permanent
- 5 Year NOL carryback for all
- 100% exclusion for qualified small business stock gains
- LIFO repeal
- Codification of economic substance doctrine



Obama's Budget Proposals

New Items

- Repeal LIFO and LCM
- Imputed interest on forward sales of stock
- Repeal 60/40 for dealers
- Restrict COLI
- Expand reporting/withholding regimes



Health Care Funding Options: Senate Finance Committee Discussion Document

- Repeal or limit employer exclusion for employer provided health insurance
- Raise 7.5% itemized deduction threshold
- Limit HSA contributions to amount of deductible
- Require medical students to pay FICA
- Extend Medicare tax to state and local employees
- Uniform tax rate on alcohol
- “Soda” tax



Health Care Funding Options: Administration Reaction

- Luke warm on new taxes such as Soda tax
- Do not support repeal of exclusion for employer-provided health insurance
 - Obama campaigned against this
 - Unions very opposed
 - Public appears opposed
- Prefer to target higher income taxpayers
 - Limit benefit of itemized deductions



Wisdom from Chairman Ben:

“Unless we demonstrate a strong commitment to fiscal sustainability in the longer term, we will have neither financial stability nor healthy economic growth.”

“We as a country are going to have to make some hard choices. We can't expect to continue to borrow, certainly not 12 percent of GDP, but not even 4 or 5 percent of GDP, indefinitely.”

Ben Bernanke, Chairman, Federal Reserve

President Obama's Tax Proposals

What's the Message?

- It could happen
- Tax may have to pay for other initiatives
 - Health care, energy, education
- Deficits will restrict the ability to
 - Deliver promised cuts
 - Avoid revenue raisers
- **It is not clear whether the income tax system can fund ultimate revenue needs**



Thank you!

Questions??

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