Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
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Refer Reply To:
CC:ITA:B06
PLR-111889-14

Date:
September 10, 2014

LEGEND

U.S. Company	=	
Foreign Company 1	=	
Foreign Company 2	=	
Foreign Company 3	=	
Unrelated Credit Agency	=	
Bankruptcy Court	=	
Trustee A	=	
Issuance 1	=	

Issuance 2	=	
Issuance 3	=	
Divestiture Transactions	=	

Pre-petition Claims	=	
State A	=	
Country A	=	
Country B	=	
Country C	=	
Date 1	=	
Date 2	=	
Date 3	=	
Date 4	=	
Date 5	=	
Date 6	=	
Date 7	=	

Petition Date	=	
Month A	=	
Year A	=	
Year B	=	
Number a	=	
Number b	=	
Number c	=	
Number d	=	
Number e	=	
f	=	
g	=	
h	=	

Dear :

This letter responds to your letter dated March 4, 2014, and subsequent correspondence, requesting a private letter ruling concerning the application of §§ 166 and 468B of the Internal Revenue Code to a proposed transaction (Proposed Transaction) as described below. In particular, you requested rulings addressing the following issues:

1. Whether a fund (Fund) to be established to resolve certain pre-petition claims (Pre-petition Claims) will be a disputed ownership fund within the meaning of § 1.468B-9 of the Income Tax Regulations.

2. Whether the transfer of money or property to the Fund in satisfaction of all or a portion of the guarantee claims (Guarantee Claims) and the transfer of the subrogation rights (Subrogation Rights) to the Fund will constitute a “payment in discharge” for purposes of § 166 and § 1.166-9, and establish the worthlessness of

the Subrogation Rights to U.S. Company such that U.S. Company can take a bad debt deduction in the year the transfers are made.

CONCLUSIONS

1. The Fund will be a disputed ownership fund within the meaning of § 1.468B-9.

2. The transfer of money or property to the Fund in satisfaction of all or a portion of the Guarantee Claims and the transfer of the Subrogation Rights to the Fund will constitute a "payment in discharge" for purposes of § 166 and § 1.166-9, and establish the worthlessness of the Subrogation Rights to U.S. Company such that U.S. Company can take a bad debt deduction in the year the transfers are made.

FACTS

U.S. Company is a U.S. corporation organized under the laws of State A and was incorporated on Date 1. U.S. Company is a member of what once was a global group of entities (hereinafter referred to as the Global Group) that consists of more than Number a legal entities in more than Number b jurisdictions. U.S. Company was the primary holding and operating company for the Global Group's U.S. operations, and is the parent of a group of U.S. corporations that files U.S. federal income tax returns on a consolidated basis (the U.S. Company Group).

The ultimate parent of the Global Group is Foreign Company 1, a corporation organized under the laws of Country A. Foreign Company 1 owns all of the common stock in Foreign Company 2, a company also organized under the laws of Country A. Prior to the disposition of business operations described below, Foreign Company 2 was Foreign Company 1's principal Country A operating subsidiary. Foreign Company 2 owns all of the common stock of U.S. Company. Foreign Company 3, a corporation organized under the laws of Country B, is also wholly owned by Foreign Company 2.

Creditor Protection Proceedings

On the Petition Date, U.S. Company, along with certain other members of the U.S. Company Group and other affiliated U.S. debtors (together, the U.S. Debtors) filed voluntary petitions for relief under chapter 11 of Title 11 of the United States Code (the Bankruptcy Code) in the Bankruptcy Court (the U.S. Bankruptcy). Certain other non-U.S. members of the Global Group similarly filed for protection from creditors in their respective jurisdictions,

(together with the U.S. Bankruptcy, the Creditor Protection Proceedings). The filings of these entities all occurred on the Petition Date,

or later that calendar year.

. Each of the entities that filed for Creditor Protection Proceedings currently remains in such proceedings (other than Number e entities in Country C that have liquidated), each is a separate corporate entity, and each is required to act in the best interests of its respective creditors in accordance with the governing law of its respective jurisdiction.

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Claims Against the U.S. Debtors

There have been numerous Pre-petition Claims asserted against U.S. Company and members of the U.S. Company Group in the U.S. Bankruptcy. A subset of those claims are the claims of bondholders against U.S. Company related to guarantees on debt issued by Foreign Company 2 (the Guarantee Claims, and the holders thereof, the Guarantee Claimants).

Prior to the commencement of the Creditor Protection Proceedings, U.S. Company guaranteed debt securities of Foreign Company 2, issued under indentures dated as of Date 2 (the Date 2 Indenture) and Date 3 (the Date 3 Indenture), among Foreign Company 2 as issuer, Foreign Company 1 and U.S. Company as guarantors, and Trustee A as trustee (the Senior Notes Guarantee). These indentures were the basis for three subsequent issuances (Issuance 1, Issuance 2, and Issuance 3) of senior notes by Foreign Company 2 (collectively the Senior Notes). All of the Senior Notes were issued prior to the commencement of the Creditor Protection Proceedings.

Pursuant to the terms of the Date 2 Indenture and Date 3 Indenture and applicable law, U.S. Company would have certain rights of subrogation against Foreign Company 2 if Foreign Company 2 were to default on any of the Senior Notes causing the guaranty clause of the relevant indentures to be invoked, and U.S. Company were to make payment on its guarantee (the Subrogation Rights). Foreign Company 2 defaulted on these obligations as a result of filing for Creditor Protection Proceedings.

The total amount of Guarantee Claims as filed by the holders of the Senior Notes and total no less than g dollars. U.S. Company's ability to make cash payments on the Guarantee Claims has been forestalled by the automatic stay imposed on all payments to pre-petition creditors of the U.S. Debtors as a result of the U.S. Bankruptcy.

The Subrogation Rights are not expected to have value to U.S. Company because there is no reasonably foreseeable scenario in which the subrogation could be enforced. U.S. Company will transfer the Subrogation Rights to the Fund and claim no federal tax deduction with respect to those rights.

Dispositions of Businesses and Assets

After entering their respective Creditor Protection Proceedings in Year A,

various members of the Global Group began a process of liquidating the assets of the Global Group by selling the assets to various purchasers through the Divestiture Transactions.

. Each Divestiture Transaction was effected through a process in which the purchaser of the relevant business and assets paid a single price into an escrow account that was established for the particular disposition (each, an Escrow),

The dispositions occurred beginning in Year A and ending in Year B. By Date 4 (the end of Year B), the Global Group had divested all of its global businesses and assets in the Divestiture Transactions. The gross proceeds from the Divestiture Transactions total approximately h dollars, which remains in the several Escrows (less certain amounts used to satisfy transaction costs and other discrete expenditures).

As a result of the agreements establishing such Escrows

. Neither U.S. Company, nor any other member of the Global Group, has the ability to individually cause the release of the funds held in any Escrow. Such a release can only occur by either (a) the agreement of all of the relevant parties to the applicable Escrow, or (b) the order(s) by a court or courts of competent jurisdiction finding a final determination of the proper allocation of such proceeds among the relevant parties.

Plan of Reorganization

PROPOSED TRANSACTION

U.S. Company proposes to file a motion with the Bankruptcy Court to enter an order permitting U.S. Company to establish a segregated bank account (referred to herein as the Fund) to be held for the benefit of certain creditors of U.S. Company, including, but not necessarily limited to the Guarantee Claimants. In reliance on the requested order, U.S. Company would transfer money or property, potentially including a portion of its interests in the Escrows and potentially other property, to the Fund. U.S. Company intends to effect this transfer on or shortly after the date the Bankruptcy Court enters an order or orders approving establishment of the Fund (the Transfer Date), and prior to the effectiveness of the Plan. In addition, U.S. Company will transfer the Subrogation Rights to the Fund.

REPRESENTATIONS

U.S. Company makes the following representations regarding the Proposed Transaction:

1) Following the date that U.S. Company transfers cash or property to the Fund, neither U.S. Company nor any ”related person,” within the meaning of § 1.468B-9(b)(6), will own at any time, directly or indirectly, any beneficial interest in the corpus or income of the Fund.

2) The Fund will be established following approval by the Bankruptcy Court. The Bankruptcy Court will retain jurisdiction over the Fund with respect to any matter arising under or related to the Plan, or any distributions from the Fund, and the allowance of Pre-petition Claims.

3) The Fund will be created for the primary purpose of resolving some or all of the outstanding disputed claims of the Guarantee Claimants and potentially some or all of the other outstanding disputed Pre-petition Claims with respect to their rights to the Fund Assets, and distributing the Fund Assets with no objective to continue or engage in the conduct of a trade or business.

4) All of the assets contributed to the Fund by U.S. Company will be passive investment assets.

5) The Fund will assume the U.S. Company’s liabilities associated with the portion of the Guarantee Claims and potentially other Pre-petition Claims as designated by the court order authorizing the Fund. The Bankruptcy Court order authorizing the Fund will establish the minimum portion of the Guarantee Claims and potentially other Pre-petition Claims that will be satisfied by distributions from the assets held by the Fund, although the amount of Guarantee Claims and other Pre-petition Claims that may be so satisfied may be increased from time to time thereafter. As of the date that U.S. Company transfers cash or property to the Fund, U.S. Company will be discharged from, and will have no responsibility for, such portion of the respective Guarantee Claims and other Pre-petition Claims that the court authorizes to be satisfied by the Fund.

6) The Fund will make distributions to the Guarantee Claimants as well as other Pre-petition Claim holders (as applicable).

7) As of the date that U.S. Company transfers cash or property to the Fund, the Fund will report all items of income, gain, deduction, and loss in accordance with § 1.468B-9(c).

8) The Fund will not receive or retain cash (or cash equivalents) in an amount expected to be in excess of a reasonable amount to meet claims and contingent liabilities (including disputed claims), to maintain the value of the assets during liquidation, or to pay administrative expenses of the Fund.

9) U.S. Company will not have refund or reversion rights in the Fund's assets or income.

10) U.S. Company will provide the statement described in § 1.468B-9(g) to the Fund administrator to be appointed no later than Date 7 of the year following each calendar year in which U.S. Company makes a transfer to the Fund. Such statement will be attached to U.S. Company's timely filed income tax return for the year of each transfer.

11) The payment or distribution of money or property to, or on behalf of, a claimant by the Fund will be made pursuant to the plan approved by the Bankruptcy Court, or as otherwise authorized by one or more Bankruptcy Court orders.

12) The Fund will not be established to resolve claims described in § 1.468B-1(c)(2).

13) The Fund will not be a liquidating trust within the meaning of § 301.7701-4(d).

14) U.S. Company will not claim ownership of, in whole or in part, or a legal or equitable interest in, the Fund assets immediately after money or property is transferred to the Fund. Accordingly, U.S. Company will not be a transferor-claimant with respect to the Fund within the meaning of § 1.468B-9(b)(8).

15) The Senior Notes Guarantee and the Unrelated Credit Agency Guarantee were entered into for a good faith business purpose of the U.S. Company, and therefore incurred in the course of its trade or business.

16) At the time U.S. Company entered into the Senior Notes Guarantee and the Unrelated Credit Agency Guarantee, there was a reasonable expectation on the part of the U.S. Company that it would not be called upon to pay the Senior Note Guarantee or the Unrelated Credit Agency Guarantee without full reimbursement from Foreign Company 2.

17) U.S. Company entered into the Senior Notes Guarantee and the Unrelated Credit Agency Guarantee in accordance with normal business practice or for a good faith business purpose.

18) Based on the facts and circumstances that existed at the time the Senior Notes Guarantee and the Unrelated Credit Agency Guarantee were entered into, a

payment by U.S. Company under the Senior Notes Guarantee and the Unrelated Credit Agency Guarantee would not constitute a contribution to capital.

19) U.S. Company has an enforceable legal duty to make certain payment to the Guarantee Claimants under the Senior Notes Guarantee and the Unrelated Credit Agency Guarantee.

20) U.S. Company will transfer the Subrogation Rights to the Fund on the Transfer Date, but will not take a deduction for the transfer of such rights.

LAW AND ANALYSIS

1. Classification as Disputed Ownership Fund

The U.S. Company's first requested ruling is that the Fund will be a disputed ownership fund under § 1.468B-9 for federal income tax purposes.

Section 468B(g)(1) provides, in part, that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. Section 468B(g)(1) authorizes the issuance of regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise. Section 1.468B-9 regarding disputed ownership funds was issued pursuant to § 468B(g).

Section 1.468B-9(b)(1) provides that a disputed ownership fund is an escrow account, trust, or fund that satisfies the following requirements. First, § 1.468B-9(b)(1)(i) requires that the escrow account, trust, or fund be established to hold money or property subject to conflicting claims of ownership. Second, § 1.468B-9(b)(1)(ii) provides that the escrow account, trust, or fund be subject to the continuing jurisdiction of a court. Third, § 1.468B-9(b)(1)(iii) provides that the escrow account, trust, or fund requires the approval of the court to pay or distribute money or property to, or on behalf of, a claimant, transferor, or transferor-claimant. Fourth, § 1.468B-9(b)(1)(iv) requires that the escrow account, trust, or fund not be a qualified settlement fund under § 1.468B-1, a bankruptcy estate (or part thereof) resulting from the commencement of a case under title 11 of the United States Code, or a liquidating trust under § 301.7701-4(d) (except as provided in § 1.468B-9(c)(2)(ii)).

Based on the facts represented by U.S. Company, the four requirements of § 1.468B-9(b)(1) will be satisfied, and as such, the Fund will be a disputed ownership fund for federal income tax purposes.

First, the Fund will be established to hold money or property subject to conflicting claims of ownership by holders of the various debts of Foreign Company 1 and Foreign Company 2 that were guaranteed by U.S. Company as well as holders of certain other

Pre-petition Claims, as applicable. See § 1.468B-9(b)(1)(i). Second, the Fund will be subject to the continuing jurisdiction of the Bankruptcy Court. See § 1.468B-9(b)(1)(ii). Third, the Fund will make distributions pursuant to the Plan approved by the Bankruptcy Court, or as otherwise authorized by one or more Bankruptcy Court orders to, or on behalf of, a claimant, transferor, or transferor-claimant. See § 1.468B-9(b)(1)(iii). Fourth, the Fund will not be established to resolve claims described in § 1.468B-1(c)(2) and therefore will not be a qualified settlement fund under § 1.468B-1. The Fund will not be a bankruptcy estate (or part thereof) resulting from the commencement of a case under title 11 of the United States Code, but will merely be an account that is established during the bankruptcy proceedings. Finally, the Fund will not be a liquidating trust under § 301.7701-4(d). See § 1.468B-9(b)(1)(iv).

Accordingly, based on the information submitted and representations made, we conclude that the Fund will be a disputed ownership fund within the meaning of § 1.468B-9.

2. Guarantor Bad Debt Deduction

Section 166 provides, in the case of a corporation, a deduction for any debt that becomes worthless during the taxable year.

Section 1.166-9(a) provides that a payment of principal or interest in discharge of part or all of a taxpayer's agreement to act as, or in a manner essentially equivalent to, a guarantor, endorser, or indemnitor of, or other secondary obligor upon, a debt obligation, is treated as a business debt becoming worthless in the taxable year of payment.

Under § 1.166-9(d), a payment may be treated as a worthless debt only if: (1) the agreement was entered into in the course of the taxpayer's trade or business or a transaction for profit; (2) there was an enforceable legal duty upon the taxpayer to make the payment (except that legal action need not have been brought against the taxpayer); and (3) the agreement was entered into before the obligation became worthless or partially worthless. An agreement is considered as entered into before the obligation became worthless if there was a reasonable expectation on the part of the taxpayer at the time the agreement was entered into that the taxpayer would not be called upon to pay the debt (subject to such agreement) without full reimbursement from the issuer of the obligation.

Section 1.166-9(e)(2) provides that with respect to a payment made by a taxpayer in discharge of part or all of the taxpayer's agreement to act as a guarantor, endorser, or indemnitor where the agreement provides for a right of subrogation or other similar right against the issuer, treatment as a worthless debt is not allowed until the taxable year in which the right of subrogation or other similar right becomes totally worthless (or

partially worthless in the case of an agreement which arose in the course of the taxpayer's trade or business).

Section 1.166-9 conditions the guarantor's bad debt deduction on an irrevocable economic outlay by the taxpayer. Both a payment in discharge of the guarantor's liability and the worthlessness of any right of subrogation are required for a bad debt deduction. Payment is a precondition to a guarantor bad debt deduction because it is the event that creates the debtor-creditor relationship between the guarantor and the debtor and it is the worthlessness of that debt that provides the basis for the guarantor's bad debt deduction. This principle is set forth in the Supreme Court's decision in *Putnam v. Commissioner*,[1] which is reflected in § 1.166-9(a).[2] The Supreme Court stated that:

> The familiar rule is that, instant upon the payment by the guarantor of the debt, the debtor's obligation to the creditor becomes an obligation to the guarantor, not a new debt, but, by subrogation, the result of the shift of the original debt from the creditor to the guarantor who steps into the creditor's shoes.[3]

The term "payment" under § 1.166-9 should be interpreted in accordance with general principals of the cash method of accounting and the economic performance regulations.[4] Both require an economic outlay by the taxpayer. For example § 1.461-4(g)(ii)(A) provides that "payment includes the furnishing of cash or cash equivalents . . . . Payment does not include the furnishing of a note or other indebtedness of the taxpayer . . . . [or] a promise of the taxpayer to provide services or property in the future". Similarly, Black Gold Energy Corp. v. Commissioner, 99 T.C. 482 (1992), aff'd. without published opinion 33 F.3d 62 (10th Cir. 1994), held that accrual method taxpayers cannot make a payment in discharge of a guaranty by substituting their own note.

Based on the facts and representations provided, we conclude that a payment to the Fund is a "payment in discharge" of the taxpayer's guarantee liability that satisfies the requirements of § 1.166-9. Thus, the transfer of money or property by the U.S. Company, including a portion of its interests in the Escrows, to the Fund in satisfaction of all or a portion of the Guarantee Claims is a "payment" for purposes of § 166 and § 1.166-9. In light of the taxpayer's representations and the transfer of the Subrogation Rights to the Fund, we conclude that U.S. Company can take a bad debt deduction in the year the transfers are made.

PROCEDURAL MATTERS

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1 352 U.S. 82 (1956).

2 *See* John C. McCoy, ed., 538-3rd T.M., Bad Debts V-A (2013).

3 352 U.S. at 85. 352 U.S. at 85.

4 See *Black Gold Energy Corp. V. Commissioner,* T.C. 482 (1992).

The rulings contained in this letter are based upon information and representations submitted by U.S. Company and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to U.S. Company. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant**.** Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Roy A. Hirschhorn
Branch Chief, Branch 6
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: