

Safe Harbor Provided for “Nominal or Token” Stock

by Robert W. Wood • San Francisco

Given the number of bankruptcies in the last few years, the interaction of the cancellation of debt (“COD”) and NOL rules have become quite significant. Although many taxpayers have not worried too much about whether stock is “nominal or token” and therefore in violation of the Section 108(e)(8)(A) rule relating to COD income, the IRS has now provided a safe harbor that is noteworthy.

In *Rev. Proc. 94-26*, the Service has stated that if common stock is issued for outstanding unsecured indebtedness in a Title XI case or insolvency workout, the issuance of common stock will not be treated as nominal or token if the stock-to-total-stock ratio equals at least 15%. This ratio is defined as the ratio of (1) the value of all common stock issued for unsecured indebtedness in the Title XI case or insolvency workout, to (2) the value of all stock of the corporation outstanding after the Title XI case or insolvency workout (including preferred stock and disqualified stock). The safe harbor is helpful in that the Service has finally promulgated a numerical calculation.

Limited Effect?

Of course, given that the Revenue Reconciliation Act of 1993 (“RRA ’93”) repealed the stock-for-debt exception to COD income (and the nominal or token concept is an exclusion from the operation of this stock-for-debt exception), it may seem of little moment. However, keep in mind that the effective date provision to the RRA ’93’s repeal of the stock-for-debt exception is unique. The repeal applies to stock transferred after 1994 in satisfaction of any debt.

Exception

However, it does not apply to stock transferred in a Title 11 or similar case, as defined in Section 368(a)(3)(A), filed before 1994. Such grandfathered bankruptcy proceedings may continue for years. ■