INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM
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Taxpayer's Name:
Taxpayer's Address:

Taxpayer's ID No:
Years Involved:

LEGEND:

Business X =
Date A =
Year AB =
AB Partnership =

Date BB =
Date B =
Date C =
Date D =
Date DE =
Date E =
Date F =
Month and Year F =
Month and Year G =
Month and Year H =
Date I =
Year I =
Year J =
a =
b =
c =
d =
e =
f =
g =
h =
i =
j =
k =
l =
m =
n =

o	=
p	=
q	=
r	=
s	=
t	=
u	=
v	=
w	=
x	=
y	=
z	=
aa	=

ISSUES:

1. Does § 1032 of the Internal Revenue Code bar a corporation that issues its stock to bondholders and unsecured trade creditors in satisfaction of their claims against the corporation from deducting any premium?[1]

2. If an expense was paid or incurred by Taxpayer, as a result of the Class 5 creditors exchanging their debt holdings in Taxpayer for newly issued stock in the reorganized Taxpayer, in years subsequent to the bankruptcy court's discharge of Taxpayer's entire liability to the Class 5 creditors, was Taxpayer's deduction for such expenses limited by § 382(h)(6)(B)?

3. Was the exchange with holders of Taxpayer's debentures of Class B common stock in the reorganized Taxpayer a payment by Taxpayer of a deductible interest expense under § 163 of the Code?

4. If, at the time of the exchange, the value of Taxpayer's Class B common stock exchanged by the debenture holders exceeded the value of the debt given up, does Rev. Rul. 68-170, 1968-1 C.B. 71, prevent an interest expense deduction by Taxpayer?

5. Was the premium paid to other (non-debenture holder) creditors deductible under § 162 or 163?

6. If an expense was paid or incurred by Taxpayer under either § 162 or § 163 as a result of the Class 5 creditors exchanging their debt holdings in Taxpayer for newly

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[1] The premium is the difference between the allowed claim for the amount owed prior to the filing of the bankruptcy petition and the value of the stock transferred in satisfaction of the claim. The issues addressed in this memorandum arise only in the event that the value of the Class B common stock exceeds the value of the debt given up. As an accrual basis taxpayer, it is assumed that Taxpayer deducted amounts that had accrued prior to the bankruptcy filing.

issued stock in the reorganized Taxpayer, when was a deduction for the expense properly accruable?

7. If an expense was paid or incurred by Taxpayer upon its discharge of its liability to the Class 5 creditors, what was the amount actually paid by Taxpayer to terminate its liability?

CONCLUSIONS:

1. Section 1032 does not bar Taxpayer from taking deductions for payments of the premium to the creditors that are otherwise deductible under the Code.

2. When a corporation does not have a "net unrealized built-in loss," § 382(h)(6)(B) is inapplicable. Since in the instant case Taxpayer has a "net unrealized built-in gain," § 382(h)(6)(B) does not limit the use of deductions for the premium.

3. To the extent that the value of Taxpayer's Class B common stock given in the exchange exceeded the value of the debentures that were received, the excess (or premium) constituted a payment of interest expense, deductible under § 163 of the Code, unless deductibility is disallowed, in whole or in part, by application of some other provision, such as § 249.

4. Rev. Rul. 68-170 does not prevent an interest expense deduction by Taxpayer of the premium of the Class B common stock over the value of the debt represented by the exchanged debentures.

5. The premiums paid on Class 5 claims other than Taxpayer's debentures constitute deductible expenses under either § 162 or 163, although the timing of the deduction of these amounts depends on the facts and circumstances of the given claim.

6. Accrual of any expense arising from the exchange of a Class 5 creditor's claim for newly issued Class B common stock is proper no earlier than the date of transfer of the Class B common stock to the creditor.

7. The amount of deductible expense that Taxpayer may accrue incident to the transfer of Class B common stock is generally the amount by which the fair market value of the total amount of stock transferred to a creditor as of the day of transfer (as indicated by its price at the close of the trade day) exceeds the amount of the allowed claim. However, a different method of valuation may be required if particular facts and circumstances affecting trade prices warrant the use of a different method on any given trade day.

FACTS:

Taxpayer, an entity engaged in Business X, operated unprofitably. On Date A, (the petition date), Taxpayer filed a voluntary petition to reorganize under Chapter 11 of the Bankruptcy Code. For about aa years, through the entire bankruptcy period, it continued operations as a “debtor in possession,” as defined in § 1101(1) of the Bankruptcy Code.

After Taxpayer filed its petition, the bankruptcy court established a committee of unsecured creditors of Taxpayer (the “creditors’ committee”) and a committee of the common stockholders of Taxpayer (the “equity committee”). Late in Year AB, as a result of negotiations involving both committees, Taxpayer established an investor bidding process with the approval of the bankruptcy court. The purpose of this action was to promote an environment in which proponents of various proposals for reorganizing Taxpayer could compete for approval of the creditors and equity holders. On Date BB, Taxpayer’s board of directors chose a proposal submitted by AB Partnership. Although the creditors’ committee originally supported a different proposal, following negotiations it accepted AB Partnership’s proposal.[2] This proposal became the basis for the plan of reorganization (the “Plan”).

The bankruptcy court approved the Plan on Date B. The Plan was approved by both creditors and stockholders on Date C, and confirmed by the bankruptcy court on Date D (the “confirmation date”). Taxpayer successfully emerged from bankruptcy protection on Date E, the effective date of the Plan (the “effective date”).

The Plan itself had four major components: (1) an infusion of fresh capital in the amount of $c by AB Partnership in exchange for (a) new stock (consisting of Class A common stock and Class B common stock)[3] and stock warrants of Taxpayer as a reorganized entity and (b) senior unsecured debt of Taxpayer; (2) a restructuring of lease obligations and put agreements, (3) the cancellation of the previously issued and outstanding equity interests in exchange for the issuance of new common stock on the effective date and (4) the exchange of old debt for new equity in the form of newly issued Class B common stock. In regard to the latter item, the Plan required the new issuance of stock in the amount of a shares with b shares of the new Class B common stock (the “distribution stock”) earmarked for the Class 5 creditors, in full satisfaction of their claims. This portion represented approximately z% of the common equity of the newly reorganized Taxpayer. Creditors in this class include holders of convertible

[2] In evaluating the Plan, Taxpayer considered the alternative of liquidation under Chapter 7 of the Bankruptcy Code, but concluded that the Plan (in lieu of liquidation) significantly enhanced the prospects for recovery for all parties. In liquidation, only holders of allowed secured claims, and possibly the holders of priority administrative claims, would receive distributions. Taxpayer’s analysis showed that holders of general, unsecured claims would receive, at best, a minimal distribution in a chapter 7 liquidation, while pre-bankruptcy stockholders stood little chance of recouping any part of their equity investment.

[3] The basic difference between Class A and Class B is that the former carries voting rights of 50 votes per share and the latter, only one vote per share. Also, Class A stock is not publicly traded.

subordinated debentures and holders of trade debt.[4]

On the effective date, Taxpayer was discharged of all legal obligations to Class 5 creditors other than the distributions required under the Plan. At the time most of the Class 5 creditor claims were still in dispute. Pursuant to the Plan, Taxpayer continued contesting disputed claims. Taxpayer also turned the distribution stock over to the control of the distribution agent to be held for the benefit of the entire class, eventually to be divided between the claimants pro rata, but without any prior determination of the amount to be distributed for any particular claim.

Under the Plan, allowed claims did not include interest on the amount of the claim from and after the petition date. See Article 1.2 of the Plan. The Plan also provided that creditors could elect to receive cash instead of stock. An electing creditor would receive cash in the amount of $d for each share of "distribution stock" to which the creditor would otherwise be entitled. AB Partnership agreed to invest an additional amount of cash (up to a maximum of $e) in Taxpayer in exchange for the stock to which the electing creditors would otherwise have been entitled. Taxpayer used this cash to pay creditors who elected to receive the cash. Pursuant to this provision of the Plan, persons holding approximately $f total Class 5 creditor claims, by their election, received cash in the aggregate amount of $g in lieu of h shares of distribution stock.

The Plan imposed three main duties on the distribution agent: (1) maintain the required portion of the distribution stock in reserve;[5] (2) make distributions to creditors

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[4] Taxpayer had issued 3 series of publicly-traded, unsecured bonds : (i) 7-3/4% Convertible Subordinated Debentures due 2010 (approximate principal balance outstanding of $o as of the petition date); (ii) 7-1/2% Convertible Subordinated Debentures due 2011 (approximate principal balance outstanding of $p as of the petition date); and (iii) 11-1/2% Convertible Subordinated Debentures due 2009 (approximate principal balance outstanding of $q as of the petition date). As for the other unsecured claims, they were composed mostly of trade payables. Total allowed Class 5 claims were ultimately determined to be $k. Of the allowed Class 5 claims, approximately $r was held by unsecured creditors other than the bondholders (i.e., trade creditors).

[5] Because Taxpayer disputed all of its unsecured claims, the process of determining and allowing the Class 5 claims against Taxpayer continued for about aa years after the effective date. As a result, on the effective date, the distribution stock was issued in the name of a "distribution agent" as trustee for eventual distribution to the Class 5 creditors. The distribution agent was required to hold a certain amount of the distribution stock in reserve until all Class 5 claims were settled. The Plan provided that the reserve hold sufficient distribution stock for distribution to all creditors holding disputed claims if all disputed claims became allowed claims in their full amounts. The reserve was to be terminated only when all disputed claims were resolved. The interim distributions were calculated as a ratio of a creditor's allowed claim to the reserve amount, and then multiplied by the number of shares distributed to Class 5 creditors. The bankruptcy court established the reserve amount, which was set initially at $i on

holding allowed claims subject to the reserve requirement; and (3) hold the distribution stock, along with any dividends and cash, in trust for the creditors.[6] All of these duties were characterized in the Plan as "ministerial functions."

In order to avail themselves of the benefits of the Plan, the debenture holders were required to surrender the certificates representing the debentures. These certificates were thereupon canceled. Under the disclosure statement, all such debentures were deemed void, canceled, and of no further force and effect as of the effective date. From that time, the holders of the debentures had only such rights to receive distributions as set forth in the Plan.

Since virtually every claim was initially disputed by Taxpayer, the only way for a claim to become an "allowed claim" was by issuance of a final order of the bankruptcy court or a higher court. The distribution provisions of the Plan required distributions to be made only for allowed claims. After receiving an order from the bankruptcy court that a claim was allowed and obtaining the taxpayer identification number of the Class 5 creditor holding the claim, Taxpayer forwarded the information as to the identity of the claimant and the amount of the allowed claim to the distribution agent. After calculating the cash or stock distribution allocable to each claimant, the distribution agent mailed checks to the Class 5 creditors electing to receive cash and forwarded information as to the identity of the claimants receiving stock and the number of shares each was to receive to Taxpayer's stock agent. The stock agent then mailed the stock certificates to the Class 5 creditors not electing to receive cash.

The market value of Taxpayer on the effective date was about $l ($m per share), based on the trading price for Taxpayer's stock on the New York Stock Exchange on the day following the effective date. Thus, the value of the b shares allotted to the Class 5 creditors under the Plan as of the effective date was $n. As stated above, the claims of this class that were ultimately allowed by the bankruptcy court totaled $k. Although the value of the Class B common stock was volatile and fluctuated substantially after the effective date, it appears that most Class 5 creditors that did not elect to receive cash in lieu of stock found their economic position with respect to Taxpayer improved by receiving stock of a value in excess of the amount of their claims.

The Plan also provided holders of preferred stock and common stock certain distribution rights. Holders of common stock received the right to purchase up to s

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Date DE. The court reduced this to $j the following year. On Date F, the bankruptcy court issued an order that the final aggregate of allowed claims of Class 5 creditors was $k. This order also terminated the reserve account.

[6] According to section 10.2.2 of the Plan, the distribution agent is a trustee for the benefit of the unsecured creditors not electing to receive cash in lieu of stock. Section 10.2.4, provided that as trustee, it was required to vote the stock which it held in the same manner and proportion as the other outstanding Class B common stock was voted.

shares of Class B common stock at the price of $d per share, plus other interests and warrants. The exercise price for the warrants was set by the bankruptcy court at $t per share in its stipulated order approving compromise of controversy and establishing (1) a binding reserve amount for purposes of distributions to unsecured creditors and (2) an estimated amount of allowed general unsecured claims for purposes of determining the exercise price of new Taxpayer warrants.[7] Holders of preferred stock received their pro rata share of $u in cash plus the right to purchase, at the price of $d per share, their pro rata share of the lesser of: (i) v shares of Class B common stock, or (ii) such lesser amount of the shares available for purchase by the holders of common stock.

In the same stipulated order, the bankruptcy court stated that the computation of the exercise price for the new warrants (of Taxpayer) was --

> expressly designed to be set at a level [that they] become exercisable only after unsecured creditors have realized an imputed recovery not less than 110% of the total allowed amount of their claims.

Taxpayer was an accrual basis, calendar-year taxpayer. For Year I and Year J, Taxpayer claimed a deduction relating to the distributions made to the Class 5 creditors. In Year I, Taxpayer claimed an interest expense deduction, for tax purposes only, of $w. In order to calculate the amount received by Class 5 creditors in Year I, Taxpayer used a value of $x per share. For Year I, the interest deduction was calculated as the difference between the allowed claim and the value of the shares distributed, multiplied by the number of shares distributed in Year I, or ($w). In order to calculate the interest deduction for Year J, Taxpayer looked at the "market price" of the stock at the time of each distribution. The deduction was calculated as the difference in value between the Plan value per share and the "market price" per share on the date of distribution multiplied by the number of shares distributed on that date.

The request for technical advice concerns the tax treatment by Taxpayer of the "premium." Taxpayer's return position in Year I and Year J was that the amounts alleged to have been paid to a creditor in excess of that creditor's claim constituted interest expense to Taxpayer and interest income to the receiving creditor. Taxpayer issued Forms 1099-INT for interest paid to creditors in Year I and Year J.

LAW & ANALYSIS:

Issue No. 1:

Section 1032(a) provides that a corporation shall recognize no gain or loss on

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[7] By order dated Date DE, the bankruptcy court confirmed the Plan and determined the exercise price based upon a compromise between Taxpayer, AB Partnership, the creditors' committee, and the equity committee. Under the Plan, the exercise price was to be calculated as the estimated amount of the Class 5 claims multiplied by 1.1 and divided by b.

the receipt of money or other property in exchange for its stock. Taxpayer argues that § 1032 provides an exception to the general rule that a corporation recognizes gain or loss under § 1001 on the transfer of property in exchange for property or services, but does not govern the corporation's items of income or deduction resulting from the transaction. Taxpayer thus maintains that § 1032 does not bar deductions for payments of premium to the creditors that are otherwise deductible under the Code.

The agent argues that, at least with respect to the bondholders, § 1032 precludes any deduction for premium paid in the form of stock. The agent agrees that § 1032 generally permits deductions for expenses paid in stock, but maintains that such deductions are only permissible if the stock payment is economically equivalent to a cash payment. In support of this theory, the agent cites to Erie Lackawanna Railroad Co. v. United States, 422 F.2d 425 (Ct. Ct. 1970).

In Erie, a corporation issued bonds in exchange for outstanding preferred stock. The bonds had a face amount of $100, and were exchanged, on a one-bond-for-one-share basis, for preferred stock that the corporation had issued in an earlier year for $100 per share. At the time of the exchange, the bonds and preferred stock were roughly equal in value, but worth less than their respective face amount and par value of $100 per bond or share. The corporation argued that it had issued the bonds at a discount which it could amortize over the life of the bonds.

The Court of Claims held that the corporation did not realize amortizable debt discount on the issuance of the bonds, and that the issue price of the bonds was the $100 the corporation originally received for the preferred stock. In reaching this conclusion, the Court reasoned as follows:

> The amount paid for the preferred stock should be considered as the cost of the bonds. The bonds were exchanged directly for the stock without additional payment by either side. Consequently, there was no increase or decrease in plaintiff's capital assets as a result of the exchange....In effect, we are simply saying that the plaintiff has not been hurt, nor has it experienced any loss, as a result of the transaction in question. Erie, 422 F.2d at 430.

The agent urges that Erie provides authority for applying § 1032 to deny a deduction for the premium. The agent argues that the payment of the premium in stock is dissimilar to a cash payment (at least with respect to the Bondholders) because Taxpayer did not incur a reduction in its assets as a result of exchanging its common stock for outstanding bonds.

It is a well-established proposition that § 1032 does not prevent a corporation from taking a deduction for an otherwise deductible expense that the corporation pays with its own stock, even if the stock is transferred in a § 1032 exchange. See, e.g., Rev. Rul. 62-217, 1962-2 C.B. 59, Rev. Rul. 69-75, 1969-1 C.B. 52, § 83(h) and Treas. Reg. § 1.83-6 (all permitting deductions for services paid in stock in non-recognition exchanges under § 1032); Duncan Indus., Inc. v. Commissioner, 73 T.C. 266 (1979) (borrower selling stock at discount to lender as part of loan agreement allowed to amortize the amount of discount over the life of the loan as a cost of obtaining the loan); Rev. Rul. 75-348, 1975-2 C.B. 75 (corporation pledging to sell shares to charity at a price below fair market value could deduct excess of fair market value over agreed price as charitable contribution).

We have not been able to find any authority for the theory that the non-recognition rule of § 1032 disallows a deduction for an otherwise deductible expense under the Erie rationale.[8] We view the holding in Erie as relating to the determination of the issue price of debt instruments issued by a corporation in exchange for its outstanding stock before the statutory changes to the original issue discount regime enacted in 1969 (and as subsequently amended).

Accordingly, § 1032 does not bar Taxpayer from taking deductions for payments of premium to creditors that are otherwise deductible under the Code.

Issue No. 2:

The agent raised the question of whether any deductions for payments of premium would be limited by § 382(h)(6)(B). Section 382(h)(6)(B) generally provides that any amount properly deductible during the "recognition period" (within the meaning of § 382(h)(7)) but which is attributable to periods before an ownership change shall be treated as a recognized built-in loss, and thus subject to limitation under §§ 382(a) and (h). However, § 382(h)(6)(B) only applies to limit the use of a post-change deduction in this manner if the corporation has a unrealized built-in loss (NUBIL) (within the meaning of § 382(h)(3)). See § 382(h)(1)(B). When a corporation does not have a NUBIL, § 382(h)(6)(B) is inapplicable. Since in the instant case Taxpayer has a NUBIG (net unrealized built-in gain), § 382(h)(6)(B) does not limit the use of deductions for the premium.

Issue No. 3:

Section 163(a) allows a deduction for all interest paid or accrued within the taxable year on indebtedness. In order for an interest deduction to be allowed, the interest expense must accrue on bona fide indebtedness. Tampa & Gulf Coast Railroad Co. v. Commissioner, 56 T.C. 1393, 1399-1400 (1971). Where a debt instrument is repurchased by an issuer for a price in excess of its adjusted issue price (as defined in § 1.1275-1(b)), the excess is deductible as interest for the taxable year in which the repurchase occurs. See §§ 1.163-7(c) and 1.163-3(c)(1). A premium paid for the early retirement of a bond issue represents an additional interest charge for the

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[8] The fact that the transfers of Taxpayer's stock for the bonds may qualify as tax-free exchanges under § 368(a)(1)(E) does not affect the conclusion that the premium can be deductible even though it is paid in stock. See, e.g., Hummel-Ross Fibre Corp. v. Comm'r, 40 B.T.A. 821 (1939) (corporation issuing stock in exchange for securities could deduct the amount of stock attributable to interest accrued on the securities).

use of the bondholder's money. See Rev. Rul. 70-368, 1970-2 C.B. 40.

For purposes of federal income tax law, the act of filing a bankruptcy petition creates substantial uncertainty as to the allowability of a claim for post-petition interest. Accordingly, post-petition interest on pre-petition unsecured debt generally is nondeductible. See In re West Texas Marketing Corp., 54 F.3d 1194 (5th Cir. 1995), cert. denied, 116 S. Ct. 523 (1995). An award of post-petition interest may be allowed, however, when the bankrupt later proves to be solvent. See Beverly Hills Bancorp v. Hine, 752 F.2d 1334, 1339 (9th Cir. 1984). The liability for post-petition interest generally remains contingent while the debtor is in a Title 11 proceeding. However, there are some recognized limited exceptions to this general rule, including the fact that a final bankruptcy court order (including the terms of a confirmed plan) may provide otherwise.

In this case, Taxpayer's debentures were surrendered and canceled as of the effective date. Thus, interest did not accrue on the debentures, for federal income tax purposes, after that date. To the extent the value of the Class B shares exceeded the principal amount outstanding on Taxpayer's debentures on their termination, the premium either represents a payment in lieu of post-petition interest or a repurchase premium. Even though the express provisions of the Plan did not provide for the payment of post-petition interest, other facts indicate that the payment was made in settlement of post-petition interest claims. Under the Plan there is a net return to the preferred and common stockholders in the form of cash, stock options, and warrant rights. Generally, post-petition interest on unsecured claims has priority over distributions to the debtor. See § 726(a) of the Bankruptcy Code. In addition, the bankruptcy court recognized that the method for computing the exercise price for Taxpayer's warrants was designed so that the warrants became exercisable only after the unsecured creditors realized an imputed recovery of not less than 110% of the total allowed amount of their claims.

Section 249 disallows a deduction to an issuing corporation for any premium paid or incurred upon the repurchase of a bond, debenture, note, or certificate, or other evidence of indebtedness which is convertible into the stock of the issuing corporation to the extent the repurchase premium exceeds an amount equal to the adjusted issue price plus a normal call premium on comparable nonconvertible bonds. A larger deduction is allowed, however, if it is demonstrated that the amount of the premium that otherwise would be disallowed as a deduction is attributable to the cost of borrowing and not the conversion feature.

Section 249 does not disallow an interest expense deduction by Taxpayer because, based upon the representations provided by Taxpayer, any premium paid by Taxpayer to the holders of Taxpayer's debentures is not attributable to the conversion feature in the debentures.[9] Therefore, if the facts demonstrate that taxpayer's

[9] We have not reviewed the terms of the debentures or, in particular, any of the terms of the conversion features in the debentures.

exchange of Taxpayer's debentures for Class B common stock is consistent with the terms of a conversion feature in Taxpayer's debentures, § 249 may disallow the deduction in part or in whole.

Issue No. 4:

In Rev. Rul. 68-170, 1968-1 C.B. 71, clarified by Rev. Rul. 74-127, 1974-1 C.B. 47, a corporation issued convertible debt subject to a provision that if the holder converted its debt prior to an interest payment date, the holder would lose the interest accruing from the previous quarterly interest payment date. A bondholder converted a bond into common stock at a time when the value of the stock exceeded the value of the converted bond. The Service concluded that the issuing corporation cannot claim an interest deduction for the difference in values where the terms of the indentures preclude the payment of interest for the accrual period of the conversion because no interest becomes due or accruable for that period. The fact that the stock had a greater value than the bond from which it was converted was irrelevant to the Service's determination of whether the corporation was entitled to a deduction for interest on bonds.

In the instant case, Rev. Rul. 68-170 does not prevent an interest expense because the interest expense arises out of the terms of the Plan, which terms were specifically recognized and confirmed by the Court, and was not based upon the mere fact that the stock had a greater value than the unsecured debt from which it was converted.

Issue No. 5:

Under a similar analysis, a premium paid on Class 5 claims other than Taxpayer's debentures may represent a deductible expense under either § 162 or 163. As with Taxpayer's debentures, the expense on the trade creditor claims, for federal income tax purposes, did not necessarily accrue on the effective date. The treatment of a premium on a trade creditor's claim is a determination that must be made on a claim-by-claim basis.[10]

Issue No. 6:

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[10] For example, one exception to this general determination is required with respect to any excess in the value of shares transferred to a contractor/creditor for which there is an on-going contractual arrangement beyond the date of transfer of the stock. Some of the claims which were duly allowed were for lease payments under leases for assets used in Taxpayer's business. Some of these leases were simply terminated under the Plan and others were modified. As to those lease arrangements that continued in modified form after the transfer of Class B common stock, if Taxpayer paid a premium to such a creditor, Taxpayer should capitalize such premium and amortize it over the remaining life of the lease. Rev. Rul. 73-176, 1973-1 C.B. 146; and Stuart v. Commissioner, 195 F.2d 176 (9th Cir. 1952).

Section 461(a) provides that the amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(2) of the Income Tax Regulations provides, in part, that under the accrual method of accounting, a liability is incurred, and generally is taken into account for federal income tax purposes, in the taxable year in which all events have occurred that establish the fact of a liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability.

Section 461(h)(1) provides that for purposes of this title, in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.

Section 1.461-1(e) of the regulations provides that in the case of interest, economic performance occurs as the interest cost economically accrues, in accordance with relevant provisions of the Code.

For an accrual method taxpayer , a liability must be fixed before it can be accrued. A liability does not accrue as long as it remains contingent. Brown v. Helvering, 291 U.S. 193 (1934).

In Eastman Kodak Co. v. United States, 534 F.2d 252 (Ct. Cl. 1976), the taxpayer sought to deduct payroll taxes attributable to its obligation to provide employee vacations in the following year. It was clear that the taxpayer had an obligation to provide the vacation pay, and the taxpayer properly accrued that, but it was not clear that it would have to pay the payroll tax. If the employee took his vacation after the maximum payroll tax payments had been made, the taxpayer would have no obligation. The court noted that “liability is measured on an item by item basis, rather than as an overall estimate.” As to the specific issue of payroll tax on the vacation pay the court held that the taxpayer could not demonstrate that it knew in December 1964 when a given employee would take a vacation in 1965. The court reasoned that the fact of liability must be certain. Therefore, the “all events” test fails of application at this point because the taxpayer could not determine precisely as of the end of 1964 the fact of tax liability on vacation pay earned by each individual employee.

In the present case, as of the effective date, Taxpayer’s obligation to pay a premium to the holders of disputed claims was not established. The amount of stock to be distributed to a creditor was dependent on the success (or failure) of the holders of disputed claims. For example, if the claimants were generally successful in asserting their disputed claims after the effective date, a lesser amount of stock would have been available for distribution to the creditor. If, on the other hand, these claimants had generally failed, the amount available for distribution would have been larger, resulting in additional premium, even though the amount of each allowed claim remained unchanged.

The amount of premium is also directly related to the value of the stock distributed. The higher the value of the stock at the time a claim is allowed and stock is transferred, the greater the likelihood of a premium and the greater the amount of such premium. On the other hand, the lower the value, the less likely the premium. Since payment was in-kind, the determination of the premium could not be made until the liability was determined.[11] Therefore, accrual of any expense arising from the exchange of a Class 5 creditor's claim for more valuable Class B common stock occurred no earlier than the transfer of the stock to the creditor.

Issue No. 7:

We express no opinion concerning the value of the Class B common stock of the reorganized Taxpayer for purposes of determining whether there was a premium and, if so, how much was paid. The valuation of stock is essentially a finding of fact that is more appropriately made in the field.

Generally for federal income tax purposes, the value of stock on any given day is deemed to be the average exchange price quoted on that day in the stock exchange where it is regularly traded, barring the existence of exceptional facts and circumstances. See, e.g., United States v. Cartwright, 411 U.S. 546, 551 (1973); Amerada Hess Corp. v. Commissioner, 517 F.2d 75, 83 (3d Cir. 1975); and Andrews v. Commissioner, 135 F.2d 314, 317 (2d Cir. 1943). Accordingly, in the absence of facts and circumstances that render the general rule inapplicable, the amount of deductible expense that Taxpayer may accrue incident to the transfer of Class B common stock is the amount, if any, by which the fair market value of the total amount of stock transferred to a creditor exceeds the amount of the allowed claim. To the extent that facts found by the revenue agent indicate that the value of such stock is something other than its average exchange price quoted on its trade day, the revenue agent should adjust the amount of the allowed deduction accordingly.

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A copy of this technical advice memorandum should be given to Taxpayer. Section 6110(k)(3) of the Code provides that a technical advice memorandum cannot be used or cited as precedent.

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[11] This analysis assumes that no trust or qualified settlement fund was created by the Plan.