In today’s economy and with struggling real estate prices, a significant tax savings opportunity may be available to real estate investors with projects that are abandoned or significantly restructured. If the taxpayer can prove an abandonment loss, it provides a significant benefit as the taxpayer will be able to claim an ordinary loss even if the property is a capital asset. However, a taxpayer’s ability to claim an ordinary loss is subject to certain limitations outlined.

Continued on next page
Internal Revenue Code Section 165 allows a taxpayer to claim a deduction for any “loss sustained during the taxable year and not compensated for by insurance or otherwise.” This deduction is equal to the adjusted basis of the property. For individuals, the loss must have been from the taxpayer’s trade or business; a transaction entered into for profit; or the result of a casualty or theft including natural disasters. Generally, this loss is ordinary even if the asset is capital.

In order to claim an ordinary loss there must be an actual “abandonment” of the property rather than a “sale or exchange” of a capital asset. Each of the following transactions has been held to constitute a “sale or exchange” rather than qualifying for an ordinary abandonment or retirement loss:

- An involuntary foreclosure sale of real property.
- A tax forfeiture of real property.
- A conveyance of real property to a mortgagee by quitclaim deed in lieu of foreclosure.
- A decline in the value of real property below the amount of nonrecourse debt associated with the property combined with a conveyance of the property by quitclaim deed to the mortgagee.
- An abandonment of property subject to nonrecourse debt.
- Relief from indebtedness associated with property.
- Extinguishment of a taxpayer’s right of redemption following a foreclosure sale of property.
- Abandonment of a land trust.

Accordingly, a taxpayer must take various steps to establish abandonment. The taxpayer must communicate with third parties that they intend to abandon the property. This communication should take the form of a written notice and should be served to lenders, partners, and others with an interest in the property. The taxpayer must act in a manner consistent with abandonment. The taxpayer should stop making additional mortgage or real estate tax payments and should not contribute any additional costs to the project.

A facts and circumstances test is used in order to determine if there was an abandonment of the property. For example, a subsequent sale or exchange of the property has been used by taxing authorities as a factor supporting the position that there was no abandonment if the property is sold for something more than salvage. However, if the taxpayer sells the property subject to a fortuitous, unsolicited sale this should not result in a denial of the abandonment loss.

Many investors own their real estate interest through a partnership interest. Although the partnership may not abandon the property, there is potential for a taxpayer to abandon his/her partnership interest so that he/she may receive an ordinary deduction. A critical element of the abandonment is that the taxpayer seeking to recognize an ordinary loss due to the abandonment and worthless of a partnership interest not be relieved of any liabilities in the partnership. Even one dollar of debt relief would appear to be sufficient to cause the transaction to be treated as a sale or exchange.

In today’s economic times, abandonment of certain real estate projects is not uncommon. This abandonment, however, may create significant tax planning opportunities if structured properly. Accordingly, careful consideration and advanced planning should be given when deciding to “abandon” a project.
AMERICAN RECOVERY AND REINVESTMENT TAX ACT OF 2009: TAX CREDIT BONDS

By Benjamin A. Davey, Senior Accountant

In the American Recovery and Reinvestment Tax Act of 2009 (ARRTA), Congress significantly expanded the tax credit bond programs available to state and local governments and entities. The purpose of these bonds is to stimulate state and municipal capital spending by allowing the issuing governments to cost-effectively finance projects, thereby creating jobs, stimulating local and regional businesses and communities. In addition to the tax advantages, the tax credit bonds may be appealing to some investors.

Common characteristics of tax credit bonds are that the bonds are non-interest bearing obligations issued as an alternative to traditional tax-exempt bonds. The holder (taxpayer) of the bonds is entitled to a nonrefundable tax credit in lieu of receiving interest payments from the issuer of the bond. The taxpayer includes the credit in gross income as if it was taxable interest, and then the taxpayer claims the tax credit to offset both regular tax and AMT. The amount annual credit is based on the applicable credit rate set by the IRS multiplied by the outstanding face amount of the bond. The amount of the credit allowed cannot exceed the excess of the sum of the taxpayer’s regular tax liability and AMT liability over the sum of certain other credits allowable. Any unused credit may be carried forward to the next year. Pass through entities such as S corporations, partnerships real estate investment companies, the credit is deemed distributed to the owners of those entities. Taxpayers must utilize Form 8912, Credit to Holders of Tax Credit Bonds, to calculate and claim the tax credit available.

The ARRTA discusses the following tax credit bonds:

QUALIFIED ZONE ACADEMY BONDS
In 1997, Congress enacted the Tax Payer Relief Act permitting Qualified Zone Academy Bonds (QZABs) to authorize debt instruments for school finance. It allows qualifying schools and/or communities to borrow at little or no interest cost. The money can only be used for qualifying schools and the funds can be used for renovation school buildings, purchasing....

Continued on next page

SELF-INSURED MEDICAL AND DENTAL PLAN DEDUCTIONS

Does your company have a self-insured medical and dental plan?

The Internal Revenue Service is allowing taxpayers to accrue liabilities on self-insured medical and dental plan benefits even though the payments occurred more than two and a half months after the close of the taxable year. This change in accounting method is automatic and can be made by filing Form 3115 with the Internal Revenue Service.

The ability to accelerate the accrued self-insurance medical expense deductions is only available if the employer uses a third-party administrator. It is assumed that when the medical service is provided to the employee, the employer’s liability has been incurred because of the certainty of the submission of the claim by the medical service provider to the third-party administrator. Therefore, the IRS is allowing taxpayers to treat the liability as incurred in the taxable year in which medical services are provided.

This automatic accounting change is a simple way to accelerate tax deductions and improve cash flow.
AMERICAN RECOVERY AND REINVESTMENT TAX ACT OF 2009: TAX CREDIT BONDS

(CONTINUED)

equipment, developing curriculum and or training school personnel. The proceeds of the bonds may not be used for new construction. QZABs reduce the burden of interest payments by giving financial institutions holding the bonds (or other debt mechanism) a tax credit in lieu of interest. The school district must still pay back the amount of money it initially borrowed, but does not have to pay any interest. The credit rate for QZABs sold on a given day is set by the Treasury Department. In 2009, the ARRTA extended the obligations issuance date through 2010 for QZABs.

QUALIFIED SCHOOL CONSTRUCTION BONDS

Under the ARRTA, a new category of tax credit bonds called Qualified School Construction Bonds (QSCBs). Section 54F of the Internal Revenue Code covers QSCBs and defines them as such if: (1) 100% of the available project proceeds of such issue are to be used for the construction, rehabilitation or repair of a public school facility or the acquisition of land in which a facility is to be constructed with part of the proceeds of such issue, (2) the bond is issued by a state or local government within the jurisdiction of which such school is located and (3) the issuer designates such bond for purpose. The Section provides that the maximum aggregate face amount of bonds issued during any calendar year that may be designated by any issuer shall not exceed the portion of the calendar year volume cap allocated to such issuer for the calendar year under. For QSCBs issued, the maximum maturity and the credit rate are determined as of the date that there is a binding, written contract for the sale or exchange of the bond. The applicable maximum maturity, the discount rate for determining the maturity, and QSCB credit rate are published for that date by the Bureau of Public Debt on its Internet site for State and Local Government Series. The act is effective for bonds issued after February 17, 2009, ad before January 1, 2011.

BUILD AMERICA BONDS

Also, the ARRTA permits an issuer to elect to have a tax-exempt bond treated as a Build America Bond (BABs), a new type of nonrefundable tax credit bond. Section 54AA of the Internal Revenue Code refers to BABs as any obligation (other than a private activity bond) if: (1) the interest on the obligation would normally be excludable from gross income, (2) the obligation is issued before January 1, 2011, and (3) the issuer of the bond makes an irrevocable election to have the rules apply. The amount of the credit is 35% of the amount of interest payable by the issuer for that interest payment date. Unlike the tax credit bonds above, the percentage is set by law not the IRS. Alternatively, for certain bonds, the issuer may elect to claim a refundable credit equal to 35% of each interest payment made under the bonds instead of allowing the holder of the bond to claim the 35% tax credit. The act is effective for bonds issued after February 17, 2009, ad before January 1, 2011.

With today’s economic state of tight credit markets and ongoing unemployment concerns, these tax credit bonds provide some relief and tax benefits to state and local government agencies as well as construction companies and workers. These innovative bond programs will try and help pursue capital projects and begin to revitalize communities while putting Americans back to work.

For further information regarding the methodology and procedures used to determine these credits, see the following:

QZABs: IRC Sec. 54E; IRS Notice 2009-30
QSCBs: IRC Sec. 54F; IRS Notice 2009-35
BABs: IRC Sec. 54AA; IRS Notice 2009-26
By Jeff Slivka, Executive Vice President, New Day Underwriting Managers LLC

PROTECTING AGAINST POTENTIAL ENVIRONMENTAL CHALLENGES

While prepping the jobsite for the initial construction work of a 15-story condominium, a subcontractor found metal drums containing a multitude of hazardous waste and chemicals. To further exacerbate the situation it was later learned that the hazardous material leaked into subsurface soils causing contamination throughout the project site. Sound familiar?

Unfortunately, stories like these run rampant through the construction business and quite often end with the responsible parties lacking the proper form of insurance to cover losses or reclamation efforts. As a result, many companies are now actively educating themselves about the impact of environmental issues and the methods for protecting themselves against the ensuing financial consequences. In most cases, this process includes conducting an environmental assessment coupled with the purchase of some form of environmental insurance such as Contractor’s Pollution Liability (CPL) insurance, which provides third-party coverage against claims arising from pollution conditions caused by a contractor’s physical, construction activities.

However, for those that do purchase CPL insurance, the trick is then to thoroughly understand the coverage benefits and pitfalls, while attempting to secure the optimal coverage afforded in the marketplace. Even though CPL insurance has become a bit more “standardized” over the past five years, what still makes the purchase of CPL fairly difficult is the fact that all 20 plus carriers offer the coverage with different terms and conditions.

In addition, even if the proper CPL insurance is purchased, one thing is for sure. The coverage will not extend to environmental conditions found by the contractor, as cited above. So, even if requiring the general contractor (GC) and/or all subcontractors to carry CPL insurance is prudent for protecting the owner against environmental liability caused by the contractor, it can...
be a bit short-sighted when looking at the bigger picture.

As a result, CPL coverage is only one-half of the protective equation that should also include the added protection provided through Pollution Legal Liability (PLL) insurance. PLL provides coverage for pollution conditions or events on, at, under or emanating from a designated location or project site. Coverage is afforded for third-party bodily injury, property damage, clean up costs and defense costs resulting from the existence of environmental conditions. A unique feature of many PLL policies is their ability to offer various and different coverage parts under one policy. Such coverage parts include, but are not limited to:

- New pollution conditions, if looking for future operational coverage
- Existing pollution conditions, could be known or unknown
- On-site clean up coverage
- Transportation coverage for material leaving the site
- Non Owned Disposal Site (NODS) coverage for the owner’s legal liability at a disposal site
- Mold liability coverage for operational and maintenance exposures

Another important aspect of coverage offered under PLL is that if a known environmental condition exists at a site, the policy may be structured to provide some type of environmental coverage for that existing contamination. Coverage is based on the type and extent of the site’s existing contamination. Lastly, coverage can typically be purchased for a period of 10 years or even longer in some instances.

Today, some carriers even offer CPL and PLL under one policy form, while others provide two separate policies that “link” the limits. Sharing the limit between both coverages is a simple way of managing costs, versus buying two separate policies with separate limits.

In the meantime, if prepared properly the coverage offered to owners and contractors through these combined forms of insurance can supply the optimal protection against possible environmental issues and the resulting financial challenges. However, knowledge is key to their successful application. Contractors need to eliminate potential surprises by thoroughly understanding the provisions outlined by each policy and the terms of coverage. When in doubt, experienced and dedicated advice should be sought from qualified professionals who specialize in these coverage areas.

Jeff Slivka is Executive Vice President of New Day Underwriting Managers in Bordentown, NJ. New Day is a specialty intermediary for insurance agents and brokers with expertise in environmental insurance, environmental risk management and construction related professional liability. Jeff can be reached at 609.298.3516 ext. 102 or jeff.slivka@newdayunderwriting.com.
With the economy continuing to struggle, it is the ideal time for a reminder as to the types of tax issues common to troubled businesses. With effective analysis and planning, companies can maximize available tax benefits and mitigate tax costs associated with issues such as net operating losses and cancellation or modification of indebtedness.

PRESERVING NOLS AND OTHER ATTRIBUTES
Troubled companies often have significant net operating losses, credit carryovers and other attributes available to offset post-restructuring income. However, they can lose these attributes as a result of ownership changes.

SECTION 382
For loss companies that experience ongoing or one-time ownership changes, pre-change net operating losses may well be limited under IRC Section 382. This may prevent the company from enjoying full utilization of these pre-change losses against future taxable income. The rules of IRC Section 382 are complex, and many tax practitioners incorrectly view them as applying only in the scenario where an outside buyer purchases 100% of the company’s stock.

To the contrary, Section 382 can apply even when no outside buyer purchases company stock, but rather existing company shareholders reallocate their ownership percentages through cross purchases or additional company issuances. As a result, Section 382 should be considered for all loss corporations experiencing any type of ownership changes.
TAX issues common to troubled businesses

(continued)

If you have a client with net operating loss carryovers who may have experienced an ownership change, Section 382 must be considered before those net operating losses can be used to offset taxable income in the current or future years.

Managing debt modifications and COD

It’s a basic tax rule that income arises from the discharge of indebtedness under Section 61(a)(12). So when a business debt is forgiven, wholly or in part, the debtor generally has income. Under IRC Section 108, cancellation of indebtedness income is excluded to the extent the debtor is insolvent immediately after the discharge. A debtor is insolvent to the extent the debtor’s liabilities exceed the fair market value of the debtor’s assets. Cancellation of indebtedness income excluded under this rule is applied to reduce tax attributes of the debtor or bankruptcy estate.

Example:

X’s debt of $8,000 is cancelled. Immediately before cancellation, X’s liabilities were $44,000 and assets at fair market value were $39,000. Since X is not insolvent after the cancellation (liabilities now $36,000 with assets of $39,000), X excludes $5,000 (reducing tax attributes for that amount) and has cancellation of indebtedness income of $3,000.

The reduction in tax attributes is applied after the tax liability for the debt cancellation year is determined. Thus if the debtor would have a net operating loss for that year, which would be carried back (to generate a refund), that net operating loss is not reduced by cancellation of indebtedness income that year. If the debtor has a net operating loss carryover to that year, which would reduce that year’s tax, that carryover is not reduced by cancellation of indebtedness income that year. Attribute reduction takes place in the following order (after tax liability for the debt cancellation year is determined, as above):

- Net operating loss.
- General business credit carryovers.
- Minimum tax credit.
- Capital losses.
- Basis. Reduce the basis of both depreciable and non-depreciable property.
- Passive activity loss and credit carryovers.
- Foreign tax credit.

The new law has special rules for partnerships and other pass-through entities and also may defer future interest deductions on new debts issued in the restructuring.

The regulations prescribe the order of reduction in the basis of the debtor’s property — e.g., basis reduced first for depreciable business or investment real property securing the debt, then depreciable personal property securing the debt, and so on.

For clients that are forced to recognize some amount of the COD income, new rules will allow a favorable deferral. The recently enacted American Recovery and Reinvestment Act of 2009 provides flexibility that will allow companies to increase cash flow through deleveraging or otherwise restructuring existing debt without the tax implications. At the election of the taxpayer, any COD income incurred upon the reacquisition of an applicable debt instrument is deferred and recognized ratably over the five-year period beginning in the fifth taxable year following a 2009 reacquisition and in the fourth taxable year following a 2010 reacquisition.

Unlike the section 108(a) exclusions of COD income, the deferral offered under section 108(i) is not limited to insolvent or bankrupt taxpayers and does not require attribute reduction. As a result, both solvent and insolvent companies are able to defer the impact of the COD event while retaining valuable net operating losses, credit carryovers and asset basis. The new
law has special rules for partnerships and other pass-through entities and also may defer future interest deductions on new debts issued in the restructuring. As a result, companies will want to carefully consider all potential exclusions and deferrals and their collateral side effects before electing to apply section 108(i).

In summary, a client who is relieved of the obligation to repay the full face amount of its outstanding debt will require careful attention. An understanding of the tax issues surrounding such a forgiveness and the planning opportunities it represents is imperative.

---

To ensure compliance with U.S. Treasury rules, unless expressly stated otherwise, any U.S. tax advice contained in this communication is not intended or written to be used, and cannot be used, by the recipient for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code.

---

CST WINS THE MAME AND FAME AWARD

The WS+B Construction Services Team (CST) won a FAME (Fabulous Achievement in Marketing Excellence) award at the ShoreBuilders Association of Central New Jersey’s (SBACNJ) 7th Annual FAME Awards and a MAME (Major Achievement in Marketing Excellence) award at the 2009 Builders League of South Jersey (BLSJ) Awards Dinner. The Construction Services Journal was recognized in the “Best Direct Mail Piece or Campaign” category by both organizations. The MAME and FAME awards recognize the “best of the best” for various marketing-related programs. The BLSJ is an organization of builders and associated businesses in the Southern New Jersey area providing professional opportunities for its members and informational resources for the community. The SBACNJ, headquartered in Lakewood, NJ, is a trade association for the homebuilding industry. Members include homebuilders, developers, architects, landscapers, subcontractors, tradesmen and consulting professionals serving those organizations in the Ocean, Monmouth, Middlesex and Mercer Counties.