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Requested Date:	10/21/2015
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SUBJECT: Reducing Tax Attributes with Post-Apportioned Cancellation-of-Debt Income

QUESTION PRESENTED

For purposes of reducing tax attributes pursuant to Internal Revenue Code (IRC) section 108, is pre-apportioned excluded cancellation-of-debt income (CODI) or post-apportioned excluded CODI applied?

CONCLUSION(S)

When reducing tax attributes pursuant to IRC section 108, post-apportioned excluded CODI is applied.

ANALYSIS AND DISCUSSION

California Revenue & Taxation Code (CRTC) section 24271(a) incorporates by reference IRC section 61. IRC section 61(a)(12) provides that gross income includes income from the discharge of indebtedness, which is another term for CODI. Accordingly, IRC section 61(a)(12) provides that if a creditor no longer pursues debtor for an outstanding debt, the debtor must treat the forgiven debt as an item of income. However, there exists an exception to this general rule.

CRTC section 24307(a) incorporates by reference IRC section 108. In pertinent part, IRC section 108(a)(1) indicates that CODI is not included in gross income if the debt is discharged either because of bankruptcy or insolvency. However, there are tax consequences if the CODI is not included in gross income. IRC section 108(b)(1) requires certain tax attributes to be reduced to the extent CODI was excluded from gross income. The specific tax attributes are reduced in the order in which they are arrayed in IRC section

108(b)(2). These tax attributes that are to be reduced include net operating loss carryovers, certain tax credits, capital loss carryovers and the basis in property.
With respect to taxpayers that conduct business within and without California and apportion their income pursuant to CRTC section 25101, a question has arisen whether the tax attributes should be reduced by pre-apportioned or post-apportioned CODI. If the CODI had occurred for reasons other than bankruptcy or insolvency, it would be taken into account as an item of income and ultimately apportioned for California purposes. Therefore, since CODI would be apportioned generally, it necessarily follows that post-apportioned excluded CODI should be applied to reduce tax attributes when applying IRC section 108. Moreover, certain items of the tax attributes that are to be reduced, such as net operating loss carryovers and capital loss carryovers, are post-apportioned amounts. Using post-apportioned excluded CODI to reduce net operating loss carryovers and capital loss carryover provides a consistent approach.