

POTENTIAL TAX MODIFICATIONS TO FACILITATE
LDC DEBT REDUCTION

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At the request of
The Bretton Woods Committee

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(1) The carry forward period for NOLs resulting from charge-offs of losses on LDC debt should be extended to the regular 15 year period, rather than the current 5 year period applicable to most banks with LDC debt. This is the rule that will take effect in 1994, and is currently the rule applicable generally to most corporate taxpayers. The 5 year period is often too short, sometimes resulting in the expiration of NOLs, which discourages partial worthlessness deductions.

(2) Recently issued guidance from the I.R.S. requires that banks apportion their loan losses between U.S. source income and foreign source income. (Notice 89-58, I.R.B. 1989-20, May 22, 1989). This is not helpful in encouraging Brady Plan participation. Losses on LDC debt should be treated as U.S. sourced, rather than foreign-sourced. This would allow for the fuller use of certain foreign tax credits that might otherwise have been lost.

(3) The alternative minimum tax book income adjustment should exclude excess book income that occurs in 1989 from a decision to forgive loans this year.

This problem arises where a bank recognized losses attributable to these loans for book purposes, but not for tax purposes, in an earlier year. Although the problem in this area should not apply after 1989, it is important to make the change to encourage partial forgiveness of debt as soon as possible.

(4) Legislative or regulatory changes should be made to confirm and clarify that a charge-off of a portion of an LDC loan from a bank's books will qualify for a conclusive presumption of worthlessness, and thus a deduction.

(5) Legislative or regulatory changes should be made to confirm the ability of a bank to take a current year deduction for partially forgiving an LDC debt even though a regulatory charge-off of the amount forgiven occurred in an earlier year when no tax deduction was taken. This rule would apply without having to prove any further deterioration of the debt since the year of the prior charge-off.

(6) Banks should be allowed to claim a deduction for amounts added to general reserves with respect to pools of LDC loans, without designating with specificity the worthless portion of each LDC loan.

(7) The special treatment of interest on foreign loans to LDC's for foreign tax credit purposes enacted in 1986 to facilitate the Baker Plan should be continued for banks that participate in the Brady Plan. The proposal to repeal such special treatment incorrectly assumes the Brady Plan does not encourage additional lending to LDCs. In fact, the Brady Plan encourages both debt forgiveness and new borrowing.