

Difficult Times Present NEW OPPORTUNITIES

We are in the worst economic crisis since the Great Depression. Each day seemingly brings a new and troubling report about the economy which send shockwaves throughout the financial markets. The U.S. government, in response, has taken administrative and legislative action on several fronts in an attempt to stabilize the volatile markets and rescue failing financial institutions. While response to these initiatives in the U.S. equity markets has been mixed, forward-thinking business people need only look a little deeper to discover that attractive business opportunities abound.

One such potential opportunity stems from rule changes implemented by the Internal Revenue Service (IRS) to facilitate the purchase of financially troubled Wachovia. The IRS announced in a recent notice that it would remove a traditional barrier and permit purchasers of distressed banks to broadly use the target's net operating losses against its own balance sheet ("NOLs"). This change allowed Wells Fargo to write off approximately \$74 billion of Wachovia's loan portfolio losses, resulting in an estimated tax saving and reduced purchase price for Wells Fargo of more than \$25 billion.

The tax code currently limits the benefits of purchasing corporations with significant operating losses and net unrealized built-in losses. If these so-called "loss corporations" (i.e. any corporation entitled to use NOL carry-forwards) experiences an ownership change (as defined in the code and regulations), the future use of its existing NOLs is generally subject to an annual limitation. Additionally, if a loss corporation has a net unrealized built-in loss in its assets, then deductions attributable to that loss are generally subject to a similar limitation.

The IRS in its Notice 2008-83 drastically changed these rules by essentially eliminating the limitations discussed above for U.S. banks, trust companies and thrifts. A profitable purchaser may now acquire a



bank through a merger or similar acquisition and offset its own operating income with NOLs of the target bank on an unlimited basis. The purchaser could also deduct amounts attributable to the net unrealized built-in losses of the target bank. The notice applies to all losses on loans and bad debts and should include most, if not all, of the mortgage based securities that have plagued many banks resulting in deep losses.

While these changes certainly helped Wells Fargo, the IRS notice creates a broad investment and tax incentive for anyone thinking about buying banks. Many banks in South Florida are struggling and in need of being purchased outright. Many of these distressed banks are likely to have net unrealized built-in losses because of massive write downs that they have taken. A buyer could potentially gain significant tax benefits by using the target's losses to shield its own operating income without the previous limitations in place. Since the notice is technically only a clarification on the official

IRS position it is subject to change in the future (particularly if economic conditions changes). Profitable buyers should not pass up the opportunity for attractive investments and big tax savings. In essence, the tax savings reduce the price paid. ²



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