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By Hilary Kramer

FOX NEWS

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ADVERTISEMENT You would think that **MCI (search)** would've learned its lesson by now. It already holds the dubious distinction of perpetrating the largest fraud in U.S. history -- \$11 billion uncovered so far. It effectively robbed shareholders of nearly \$180 billion in market value as a result. And the company is asking for debt forgiveness of approximately \$36 billion as it emerges from bankruptcy.

As if that wasn't enough, MCI now wants to use a loophole in the tax code to avoid paying some future taxes. Loophole? At an amount between \$2.5-5.5 billion of potential taxes evaded, it's not a loophole -- it's more like the Lincoln Tunnel.

Traditionally, companies are required to pay taxes on canceled debt, treating it as ordinary income. But when a company emerges from bankruptcy, the forgiven debt is often excluded from ordinary income, under the philosophy that bankrupt companies should be given every chance to succeed. However, these bankrupt companies are supposed to apply any tax benefits they've earned (that is, from Net Operating Losses) against the debt forgiven from the bankruptcy process. In other words, bankrupt companies aren't supposed to use their prior operating losses to offset future profits, unless those losses are first applied to the "income" provided by their canceled debt.

Rather than following this approach, MCI has chosen instead to use a little tax loophole, asserting that the debt and the losses were incurred by separate divisions of the company. Using this reasoning, the company can take advantage of the bankruptcy exemption and avoid taxes on the entire \$36 billion in debt forgiveness. Yet MCI believes it can still separately claim the tax benefits of NOLs (Net Operating Losses) on its \$6.6 billion in losses through 2001 -- this doesn't even include the billions more in subsequent losses it may accrue. At a 38 percent tax rate, the existing NOLs alone amount to over \$2.5 billion in taxes MCI would avoid.

On the issue of the bankruptcy exemption, Sen. Kent Conrad, D-S.D., ranking member of the **Senate Budget Committee (search)**, stated that it "was meant to give bankrupt companies some breathing space to get back on their feet, so they could pay their taxes some day. WorldCom is twisting the law to get out of paying those taxes forever."

Thankfully, MCI hasn't been able to fool as many people in this scheme as it did with its accounting scandal. In a rare bipartisan effort, Sens. Rick Santorum, R-Pa., and Kent Conrad, D-N.D., introduced legislation this week to close that glaring loophole in the tax code.

The code would require all tax benefits to be aggregated at the consolidated level, ending this type of aggressive accounting and preventing companies like MCI from treating itself as separate tax filing entities. (Prior to its need for the loophole, of course, MCI/WorldCom already filed its income taxes on a consolidated basis.) The result leaves MCI as a competitive entity while it emerges from bankruptcy, but without the unfair competitive advantage over its rivals of enormous tax breaks.

So this legislation not only provides an easy fix to a loophole that corporations like



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MCI are attempting to exploit, it's also good tax policy. After successfully emerging from bankruptcy and becoming profitable, the revision allows the government to begin collecting taxes on the companies' earned income. Absent this new legislation, companies can abuse the tax loophole and avoid taxes on future income up to their net operating losses. In MCI's case, probably the next \$10 billion or more of income will be tax-free if the loophole isn't closed.

Sadly, however, this whole issue raises questions about if we've really seen the last of MCI's attitude of accounting manipulation. Sen. Santorum stated, "By attempting to utilize this loophole, MCI/WorldCom is demonstrating that it is not, in fact, a new company. Instead, it is the same reckless company that we have come to know."

Some people just never learn.

Hilary Kramer serves as a business news contributor at FOX News Channel. She joined the network as a regular guest on **Cashin' In** in May 2001.

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