NEW YORK STATE BAR ASSOCIATION

One Elk Street, Albany, New York 12207 PH 518.463.3200 www.nysba.org

TAX SECTION

2019-2020 Executive Committee

DEBORAH L. PAUL
Chair
Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York,. NY 10019
212/403-1300
ANDREW H. BRAITERMAN
First Vice-Chair
212/837-6315
GORDON E. WARNKE
Second Vice-Chair
212/997-0500
ROBERT CASSANOS
Secretary
212/859-8278
COMMITTEE CHAIRS:
Bankruptcy and Operating Losses
Daniel M. Dunn
Stuart J. Goldring
Compliance, Practice & Procedure
Elliot Pisem
Bryan C. Skarlatos
Consolidated Returns
William Alexander
Shane J. Kiggen
Corporations
Daniel Z. Altman
Michael T. Mollerus
Cross-Border Capital Markets
Philip R. Wagman
Andrew R. Walker
Cross-Border M&A
Joshua M. Holmes
Ansgar A. Simon
Debt-Financing and Securitizations
John T. Lutz
Michael B. Shulman
Estates and Trusts
Austin Bramwell
Alan S. Halperin
Financial Instruments
Lucy W. Farr
Jeffrey Maddrey
"Inbound" U.S. Activities of Foreign Taxpayers
Peter J. Connors
Peter F. G. Schuur
Individuals
Megan L. Brackney
Steven A. Dean
Investment Funds
James R. Brown
Pamela L. Endreny
Multistate Taxation
Arthur R. Rosen
Jack Trachtenberg
New York City Taxes
Sherry S. Kraus
Irwin M. Slomka
New York State Taxes
Paul R. Comeau
Joshua E. Gewolb
"Outbound" Foreign Activities of U.S. Taxpayers
William A. Curran
Andrew P. Solomon
Partnerships
Phillip J. Gall
Sara B. Zablotney
Pass-Through Entities
Edward E. Gonzalez
Amanda H. Nussbaum
Real Property
Marcy Geller
Jonathan R. Talansky
Reorganizations
Neil J. Barr
Peter A. Furci
Spin Offs
Tijana J. Dvornic
Lawrence M. Garrett
Tax Exempt Entities
Stuart Rosow
Richard R. Upton
Taxable Acquisitions
David W. Mayo
Richard Nugent
Treaties and Intergovernmental Agreements
Lee E. Allison
David R. Hardy

MEMBERS-AT-LARGE OF EXECUTIVE COMMITTEE:

Jason R. Factor, Meyer H. Fedida, Andrew M. Herman, Elizabeth T. Kessenides, Adam Kool, Brian Krause, Stuart E. Leblang, Jiyeon Lee-Lim, William L. McRae, Kara L. Mungovan, Eschi Rahimi-Laridjani, Yaron Z. Reich, David M. Rievman, David M. Schizer, Stephen E. Shay, Eric B. Sloan, Eric Solomon, Linda Z. Swartz, Dana L. Trier, Eric Wang

Report No. 1425
November 5, 2019

The Honorable David J. Kautter
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable Michael J. Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: *Report No. 1425 – Report on Tax Fungibility of Debt Instruments*

Dear Messrs. Kautter, Rettig, and Desmond:

I am pleased to submit our Report No. 1425 commenting on the rules for determining whether two debt instruments with the same commercial terms can be treated as fungible for U.S. federal income tax purposes. The Report focuses principally on the qualified reopening rules of Treasury Regulation Section 1.1275-2(k). The Report also addresses other rules relating to tax fungibility of debt instruments, such as the definition of "issue" in Treasury Regulation Section 1.1275-1(f).

FORMER CHAIRS OF SECTION:

Peter L. Faber, Alfred D. Youngwood, Gordon D. Henderson, David Sachs, J. Roger Mentz, Willard B. Taylor, Richard J. Hiegel, Herbert L. Camp, Arthur A. Feder, James M. Peaslee, Peter C. Canellos, Michael L. Schler, Carolyn Joy Lee, Richard L.Reinhold, Steven C. Todrys, Harold R. Handler, Robert H. Scarborough, Samuel J. Dimon, Andrew N. Berg, Lewis R. Steinberg, David P. Hariton, Kimberly S. Blanchard, Patrick C. Gallagher, David S. Miller, Erika W. Nijenhuis, Peter H. Blessing, Jodi J. Schwartz, Andrew W. Needham, Diana L. Wollman, David H. Schnabel, David R. Sicular, Stephen B. Land, Michael S. Farber, Karen Gilbreath Sowell

We appreciate your consideration of our Report. If you have any questions or comments, please feel free to contact us and we will be glad to assist in any way.

Respectfully submitted,

Deborah L. Paul
Chair

Enclosure

Cc:

Krishna Vallabhaneni
Tax Legislative Counsel
Department of the Treasury

John Cross
Associate Tax Legislative Counsel
Department of the Treasury

Michael Novey
Associate Tax Legislative Counsel
Department of the Treasury

Erika W. Nijenhuis
Senior Counsel
Department of the Treasury

Helen Hubbard
Associate Chief Counsel (Financial Institutions & Products)
Internal Revenue Service

David B. Silber
Special Counsel
Internal Revenue Service

William E. Blanchard
Senior Counsel to Associate Chief Counsel
Internal Revenue Service

Jeffrey T. Rodrick
Special Counsel to the Associate Chief Counsel
Internal Revenue Service

Diana Imholtz

Special Counsel to the Associate Chief Counsel
Internal Revenue Service

Report No. 1425

NEW YORK STATE BAR ASSOCIATION TAX SECTION

REPORT ON
TAX FUNGIBILITY OF DEBT INSTRUMENTS

November 5, 2019

Table of Contents

Page

I. INTRODUCTION 1

A. Why Is Tax Fungibility Important to the Capital Markets? 1

B. A Brief History of the Rules Governing Tax Fungibility 2

C. Overview of Our Recommendations 5

II. RECOMMENDATIONS REGARDING ANNOUNCEMENT DATE VALUE TESTING AND ACTUAL ISSUE PRICE TESTING 6

A. Overview of Announcement Date Value Testing and Actual Issue Price Testing 6

B. Recommended Changes With Respect to Announcement Date Value Testing 9

C. Recommended Changes With Respect to Actual Issue Price Testing 16

III. RECOMMENDED CHANGES TO THE QUALIFIED REOPENING RULES TO ADDRESS VARIABLE RATE DEBT INSTRUMENTS AND OTHER DEBT INSTRUMENTS WITH FLUCTUATING YIELDS 18

A. The Existing Yield Tests Are Not Well Suited for Fluctuating Yield Debt Instruments 18

B. Recommended Changes to Address Fluctuating Yield Debt Instruments 20

IV. OTHER CHANGES TO ADDRESS ISSUES THAT ARISE FREQUENTLY IN MARKET PRACTICE 23

A. The “Identical Terms Requirement” (in Both the Qualified Reopening Rules and the Definition of Issue) Should Be Replaced With a “Commercial Fungibility” Requirement 24

B. If a Reopening Is Not Intended To Be Commercially Fungible Until Some Time After the Reopening Date, the Commercial Fungibility Requirement Need Not Be Satisfied Until Such Time 25

C. The Underwriter Rule, the 13 Day Rule and the Definitions of Issue Date Should Be Clarified Where Underwriters Acquire Debt Instruments Pursuant to a Financing Commitment and Are Unable to Achieve a Successful Syndication 28

D. The 13 Day Rule Should Be Relaxed For Overallotment (“Greenshoe”) Options 30

V. TECHNICAL IMPROVEMENTS TO THE RULES GOVERNING TAX FUNGIBILITY 31

A. How Should the Qualified Reopening Tests Apply to Additional Debt Instruments Issued Within the Same 13 Day Period? 31

B. Is the 13 Day Rule Really a 12 Day Rule? 32

Table of Contents
(continued)

Page

C. The De Minimis OID Test in the Qualified Reopening Rules Should Be Clarified 32

D. The Qualified Reopening Rules Should Apply Based on the Tax Treatment of the Applicable Debt Instruments to the Holders....33

E. Additional Debt Instruments Issued in a Qualified Reopening Generally Should Be Deemed to Have the Same Term (Duration) as the Original Debt Instruments in Determining Whether the Additional Debt Instruments Will Be Considered Securities for Purposes of the Rules Governing Spinoffs and Reorganizations....33

F. The Qualified Reopening Rules Should Not Be Used to Circumvent the AHYDO Rules 34

G. Debt Instruments Issued as Part of the Same Issue under the 13 Day Rule Generally Cannot Also Be Part of an Issue Including Debt Instruments Issued after the 13 Day Period 34

H. Additional Debt Instruments Should Include Existing Debt Instruments That Are Deemed Reissued for U.S. Federal Income Tax Purposes 35

I. For Purposes of Applying the Small Issuance Exception to Additional Debt Instruments, the Original Debt Instruments Should Be Treated as Part of the Same Issue as the Additional Debt Instruments 35

J. If Additional Debt Instruments Are Issued in a Qualified Reopening, What Should the Issue Price of Such Additional Debt Instruments Be for Other Purposes of the Code?....36

VI. A DEEMED OID ELECTION WOULD EXPAND THE OPPORTUNITY FOR TAX FUNGIBILITY WITHOUT CONVERTING ANY ADDITIONAL HOLDER OID INTO MARKET DISCOUNT....37

A. A Deemed OID Election Would Be Beneficial in the Current Market Environment, in which Issuers Frequently Seek to Do Tax Fungible Reopenings More Than Six Months after Issuance of the Original Debt Instruments....37

B. Deemed OID Elections Could Help Some Issuers That Are Pursuing Debt Roll-Ups But Are Unable to Satisfy the Strict Requirements of Rev. Proc. 2001-21 38

C. What Effect Would a Deemed OID Election Have and When Would An Election Be Permitted? 40

D. How Would a Deemed OID Election Be Made and What Reporting and Notice Requirements Would the Issuer Have?....43

APPENDIX.... A-1

New York State Bar Association Tax Section

Report on Tax Fungibility of Debt Instruments

I. Introduction

This Report comments on the rules for determining whether two debt instruments with the same commercial terms can be treated as fungible for U.S. federal income tax purposes ("Tax Fungibility").[1] Two debt instruments are Tax Fungible if they have (or are deemed to have) identical U.S. federal income tax consequences to lenders or holders (collectively, "holders"), including the same amount of original issue discount ("OID").

This Report focuses principally on the qualified reopening rules in Treas. Reg. § 1.1275-2(k)[2] (the "qualified reopening rules"), but also addresses other rules that affect Tax Fungibility, such as the definition of "issue" in Treas. Reg. § 1.1275-1(f).

In recent years, Tax Fungibility has become a significant issue in the capital markets and updated guidance is needed on a range of topics.

A. Why Is Tax Fungibility Important to the Capital Markets?

Tax Fungibility is important to the capital markets because borrowers and issuers (collectively, "issuers") frequently need to issue debt instruments in amounts that are too small to be marketed effectively as a separate tranche of debt (with a separate CUSIP, ISIN or similar identifying number or other designation as a separate tranche of debt (collectively, a "CUSIP number")). An issuer in this situation that has a large, liquid tranche of existing debt instruments (the "original debt instruments") will often address the marketing issue by structuring the new debt instruments as a "reopening" of the original debt instruments (with the same commercial terms as the original debt instruments) that can trade under the same CUSIP number as the original debt instruments ("additional debt instruments").

A reopening can benefit the issuer and the holders of both the original debt instruments and the additional debt instruments. The issuer gets better financing terms and the holders get debt instruments with enhanced liquidity. But the challenge in pursuing a reopening is that, even

---

[1] This Report reflects solely the views of the New York State Bar Association Tax Section and not those of the NYSBA Executive Committee or the House of Delegates. The principal authors of this Report are Craig Horowitz and Jiyeon Lee-Lim. Significant contributions early in the process were made by Erika Nijenhuis. Helpful comments were received from Bora Bozkurt, Andy Braiterman, Peter Connors, Ann Creed, Michael Farber, Lucy Farr, Marcy Geller, Jeffrey Hochberg, Robert Kantowitz, Adam Kool, Stephen Land, Aliza Levine, John Lutz, Jeffrey Maddrey, Michael Mollerus, Richard Nugent, Deborah Paul, Eschi Rahimi-Laridjani, Arvind Ravichandran, Michael Schler and Sara Zablotney.

[2] Unless other indicated, "Section" references are to the Internal Revenue Code of 1986, as amended (the "Code"), and "Treas. Reg. §" references are to the current Treasury Regulations promulgated thereunder.

though the additional debt instruments and the original debt instruments have the same commercial terms (*i.e.*, are "commercially fungible"), the additional debt instruments cannot have the same CUSIP number unless the additional debt instruments are also Tax Fungible (because debt instruments with the same CUSIP number cannot be tracked separately for tax reporting purposes).

Since 2012, when the existing qualified reopening rules were issued (the "2012 Final Regulations"), Tax Fungibility has become a more significant issue in the capital markets. In 2012, reopenings generally were limited to offerings of fixed rate bonds. But, since that time, reopenings have become much more common for variable rate debt instruments such as bank loans, and in transactions other than cash offerings of debt instruments, such as exchange offers.

As Tax Fungibility has become more important, concerns have surfaced about the existing rules. The rules are intended to provide issuers (and other market participants) with certainty, at the inception of the reopening process, that Tax Fungibility can be achieved. But technical issues prevent the rules from doing so. The rules are not designed to accommodate variable rate debt instruments, and do not specifically address additional debt instruments that, when issued, are not commercially fungible with the original debt instruments but are expected to become commercially fungible (and Tax Fungible) within a short time thereafter (such as debt issued by "escrow issuers," and unregistered debt that, when registered, is intended to become commercially fungible (and Tax Fungible) with existing registered debt). The rules are also not well suited for common commercial transactions such as exchange offers and issuances of debt instruments pursuant to the exercise of "greenshoe" options.

In 2011 and 2012, the New York State Bar Association Tax Section (the "Tax Section") addressed Tax Fungibility in a limited manner, as part of larger reports on the regulations that govern when debt instruments are deemed to be publicly traded for purposes of Section 1273 (the "Public Trading Regulations").[3] This Report recommends a more comprehensive update of the rules governing Tax Fungibility.

B. A Brief History of the Rules Governing Tax Fungibility

Prior to 2001, two debt instruments that were commercially fungible could be Tax Fungible only if (1) the two debt instruments actually had identical U.S. federal income tax consequences to holders or (2) the two debt instruments were deemed Tax Fungible because they were considered part of the same "issue." Two debt instruments were treated as part of the same "issue" only if the debt instruments had the same credit and payment terms and were sold reasonably close in time either pursuant to a common plan or as part of a single transaction or a series of related transactions.[4]

---

[3] See NYSBA Tax Section Report No. 1237, Report on Proposed Regulations on the Definition of Public Trading (April 6, 2011), at 22-24; and NYSBA Tax Section Report No. 1276, Comments on Final Regulations on the Definition of Public Trading under Section 1273 and Related Issues (November 12, 2012), at 8-10.

[4] See Treas. Reg. § 1.1275-1(f)(1) (1994), T.D. 8517, 1994-1 C.B. 38, 66.

In 2001, Treasury and the IRS (collectively, "Treasury") recognized the importance of Tax Fungibility to the capital markets by issuing regulations that permitted "qualified reopenings" (the "2001 Final Regulations").[5] Qualified reopenings would be deemed Tax Fungible even though, absent the qualified reopening rules, the additional debt instruments would have been issued with a different amount of OID than the original debt instruments and would not have been part of the same issue as the original debt instruments.

In many cases, qualified reopening treatment would result in the conversion of some OID of holders ("Holder OID") into market discount. Additional debt instruments issued in a qualified reopening would be deemed to have the same issue price, adjusted issue price (to holders), issue date and amount of OID as the original debt instruments.[6] Accordingly, some conversion of Holder OID into market discount would occur in any case in which the actual issue price of the additional debt instruments, determined without regard to the qualified reopening rules (the "Actual Issue Price"), would have been lower than the deemed issue price of the additional debt instruments under the qualified reopening rules (*i.e.*, the adjusted issue price of the original debt instruments on the date on which the additional debt instruments were actually issued).[7] Such conversion is disfavored by Treasury because holders subject to U.S. federal income taxation generally must include OID in gross income (as ordinary income) as the OID accrues, whereas such holders generally do not have to include accrued market discount in income until the applicable debt instrument is sold and, upon a sale, are required to include the accrued market discount in income only to the extent that such sale results in a taxable gain.[8]

The 2001 Final Regulations limited the circumstances in which qualified reopenings would be permitted, in order to balance the importance of expanded Tax Fungibility to the capital markets against concerns about converting Holder OID into market discount.[9] For the first six months after the original debt instruments were issued, a qualified reopening generally would be permitted as long as the yield of the original debt instruments (based on their fair market value ("value") on the "announcement date" of the reopening (the "Announcement Date")[10]) did

---

5 Treas. Reg. § 1.1275-2(k) (2001), T.D. 8934, 2001-1 C.B. 904.

6 See Treas. Reg. § 1.1275-2(k)(1) (2001), supra note 5, at 909 (additional debt instruments issued in a qualified reopening have the same issue date, the same issue price, and (with respect to holders) the same adjusted issue price as the original debt instruments).

7 The issuer's OID consequences are unaffected by qualified reopening treatment. See Treas. Reg. § 1.163-7(e), which requires an issuer to adjust its deduction for interest expense to offset the impact of the qualified reopening rules.

8 See Section 1272 (inclusion of OID) and Sections 1276 and 1278 (treatment of market discount).

9 See Preamble to Prop. Treas. Reg. § 1.1275-2(k) (1999), 1999-2 C.B. 583, 584 ("The qualified reopening rules attempt to strike a balance between tax policy concerns about the conversion of OID into market discount and the need to have the tax rules reflect current capital market practices.").

10 The "Announcement Date" was the later of seven days before the date on which the price of the additional debt instruments was established or the date on which the issuer's intent to reopen a security was publicly announced through one or more media, including an announcement reported on the

not exceed 110% of the yield of the original debt instruments (or, if the original debt instruments were issued with de minimis OID, 110% of their coupon rate) at the time of their issuance (the "110% Yield Test"). After the six month window had closed, a qualified reopening would be permitted only if the additional debt instruments, on a stand-alone basis (*i.e.*, without the application of the qualified reopening rules), would have been issued with no more than de minimis OID (the "De Minimis OID Test"). Thus, some conversion of Holder OID into market discount would be permitted, but only for reopenings occurring within six months after the original debt instruments were issued.

Under either test, a qualified reopening would be permitted only if, at the time of the reopening, the original debt instruments were publicly traded for purposes of Section 1273 (the "Public Trading Requirement"). The rationale for this requirement will be discussed later in Part II of this Report.

The 2001 Final Regulations also narrowed and clarified the definition of "issue." Even if additional debt instruments were issued pursuant to a common plan or as part of a single transaction or series of related transactions that included the issuance of the original debt instruments, the additional debt instruments could no longer be part of the same issue as the original debt instruments unless the additional debt instruments were "issued within a period of thirteen days beginning with the date on which [the original debt instruments were] issued to a person other than a bond house, broker or similar person or organization acting in the capacity of an underwriter, placement agent, or wholesaler."[11] As a result of this new rule (the "13 Day Rule"), a reopening occurring after the 13 day period could be Tax Fungible only if the reopening were a qualified reopening.[12]

The 2001 Final Regulations remained largely unchanged until January 2011, when Treasury proposed new regulations that would allow qualified reopenings of certain non-publicly traded debt instruments that were issued for cash.[13]

In April 2011, the Tax Section proposed targeted revisions to the qualified reopening rules.[14] The two main recommendations were (1) to adopt a third qualified reopening test (the "100% Yield Test"), under which an issuer generally could do a qualified reopening more than

---

standard electronic news services used by security broker-dealers (for example, Reuters, Telerate, or Bloomberg). Treas. Reg. § 1.1275-2(k)(2)(iv) (2001), supra note 5, at 910.

[11] Treas. Reg. § 1.1275-1(f)(1)(iii) (2001), T.D. 8934, 2001-1 C.B. 904, 909.

[12] See Preamble to Prop. Treas. Reg. § 1.1275-2(k) (1999), supra note 9, at 584 ("The IRS and the Treasury Department believe that reopenings should be done through the qualified reopening rule…, not through an expansive interpretation of the regulatory definition of issue…. If an issuer wants to reopen more than 13 days after the initial offering, the sole test should be whether the reopening qualifies under the proposed qualified reopening rules.").

[13] See Prop. Treas. Reg. § 1.1275-2(k) (2011), 2011-8 I.R.B. 521, 525.

[14] See NYSBA Tax Section Report No. 1237, supra note 3, at 22-24.

six months after issuance of the original debt instruments as long as the yield of the original debt instruments (based on their value as of the Announcement Date) did not exceed 100% of the yield of the original debt instruments (or, if the original debt instruments were issued with de minimis OID, 100% of their coupon rate) at the time of their issuance[15] and (2) to allow an issuer to satisfy any of the three qualified reopening tests (*i.e.*, the 110% Yield Test, the new 100% Yield Test and the De Minimis OID Test (the "Qualified Reopening Tests")) by reference to either the value of the original debt instruments as of the Announcement Date ("Announcement Date Value Testing") or the Actual Issue Price ("Actual Issue Price Testing").

The 2011 proposed regulations were finalized in September 2012 (the "2012 Final Regulations").[16] The 2012 Final Regulations adopted the new 100% Yield Test and made some minor revisions to the 2001 Final Regulations.

In November 2012, the Tax Section proposed targeted changes to the 2012 Final Regulations, including (1) allowing an issuer to satisfy any of the three Qualified Reopening Tests based on either Announcement Date Value Testing or Actual Issue Price Testing and (2) technical changes to ensure that both Announcement Date Value Testing and Actual Issue Price Testing work in the intended fashion.[17]

To date, there have been no changes to the 2012 Final Regulations.

C. Overview of Our Recommendations

Part II of this Report discusses Announcement Date Value Testing and Actual Issue Price Testing, and then makes recommendations to expand the permitted use of, and improve the operation of, each testing methodology.

Part III of this Report recommends changes to the qualified reopening rules to address variable rate debt instruments and other debt instruments with yields that may fluctuate without resulting in a deemed reissuance of such instruments for purposes of Treas. Reg. § 1.1001-3.

Part IV of this Report recommends changes to the qualified reopening rules and other rules that affect Tax Fungibility to address issues that arise frequently in market practice.

Part V of this Report recommends technical improvements to the qualified reopening rules and other rules that affect Tax Fungibility.

---

[15] As discussed later in this Report, the new 100% Yield Test was an appropriate alternative to the De Minimis OID Test for reopenings occurring more than six months after issuance of the original debt instruments because, like the De Minimis OID Test, the 100% Yield Test should not result in any conversion of Holder OID into market discount.

[16] See Treas. Reg. 1.1275-2(k), T.D. 9599, 2012-40 I.R.B. 417, 422-23.

[17] See NYSBA Tax Section Report No. 1276, supra note 3, at 8-10.

Part VI of this Report recommends a new issuer election (a "Deemed OID Election") that could expand the opportunity for Tax Fungibility without converting more Holder OID into market discount. A Deemed OID Election would be beneficial in the current market environment, in which issuers frequently seek to do Tax Fungible reopenings more than six months after issuance of the original debt instruments. In addition, Deemed OID Elections could help solve some Tax Fungibility issues that arise currently with respect to certain "debt roll-ups."

The appendix to this Report provides suggested regulatory language for implementing our recommendations.

II. Recommendations Regarding Announcement Date Value Testing and Actual Issue Price Testing

This Part II addresses Announcement Date Value Testing and Actual Issue Price Testing because these two testing methodologies are integral to the proper application of the qualified reopening rules, regardless of which Qualified Reopening Test (*i.e.*, the 110% Yield Test, the 100% Yield Test or the De Minimis OID Test) applies or which type of debt instrument (*e.g.*, fixed rate or variable rate) or transaction (*e.g.*, cash offering or an exchange offer) is involved. Since the 2001 Final Regulations were issued, there has been uncertainty about the intended purpose of each testing methodology, the circumstances in which each methodology should be permitted (or required), the proper application of each methodology (including the proper date to be used for testing) and whether a Public Trading Requirement is appropriate.

A. Overview of Announcement Date Value Testing and Actual Issue Price Testing

1. *Why Do We Need Announcement Date Value Testing?*

Treasury introduced the concept of Announcement Date Value Testing (*i.e.*, applying the Qualified Reopening Tests by reference to the value of the original debt instruments as of the Announcement Date (the "Announcement Date Value")) to provide certainty, at the inception of the reopening process, as to whether qualified reopening treatment will apply. Treasury recognized this need for certainty in the 2001 Final Regulations, which contained a formulation of Announcement Date Value Testing that differed significantly from the formulation contained in the 1999 proposed regulations (the "1999 Proposed Regulations"). The 1999 Proposed Regulations had required an issuer seeking qualified reopening status to satisfy a two-pronged yield test: a 107.5% yield test based on trading of the original debt instruments seven days before the reopening was priced and a 115% yield test based on the actual trading price of the additional debt instruments.[18] This two-pronged test could have disqualified a reopening based on changes in the market price of the original debt instruments after the reopening process had commenced. The 2001 Final Regulations eliminated the second test in response to comments that a second test could be disruptive to issuers, dealers, traders and investors that had arranged their affairs in reliance on the reopening coming to market.[19]

---

[18] See Prop. Treas. Reg. § 1.1275-2(k)(3) (1999), supra note 9, at 586.

[19] See Preamble to Treas. Reg. § 1.1275-2(k) (2001), supra note 5, at 906 ("Commentators suggested that the two-part yield test be replaced with a single yield test. According to the commentators, by

Announcement Date Value Testing will, in some cases, allow a reopening to be a qualified reopening even though the reopening would have failed the Qualified Reopening Tests based on Actual Issue Price Testing (*i.e.*, even though the actual amount of Holder OID that will be converted into market discount is greater than the amount that Treasury intended to allow), an acknowledgment that providing certainty to market participants at the inception of the reopening process is more important than achieving an accurate result in every case.

The certainty that Announcement Date Value Testing provides is important to market participants regardless of which Qualified Reopening Test applies in a particular case. Yet, in the 2001 Final Regulations, Treasury allowed Announcement Date Value Testing for purposes of the 110% Yield Test but not for purposes of the De Minimis OID Test.[20] This issue is addressed below in Section B of this Part II.

2. *What Is the Purpose of the Public Trading Requirement?*

The Public Trading Requirement is important for Announcement Date Value Testing because that testing methodology allows an issuer to apply the Qualified Reopening Tests by reference to the Announcement Date Value, regardless of the Actual Issue Price. The Public Trading Requirement ensures that the issuer's determination of the Announcement Date Value is reliable and can be verified by the IRS.

In contrast, Actual Issue Price Testing applies the Qualified Reopening Tests by reference to the Actual Issue Price. An Actual Issue Price exists in every case, regardless of whether the original debt instruments are publicly traded.[21] Accordingly, the Public Trading Requirement should be irrelevant to Actual Issue Price Testing. Yet both the 2001 Final Regulations and the 2012 Final Regulations include the Public Trading Requirement as a condition of satisfying the De Minimis OID Test,[22] even though, as noted above, only Actual Issue Price Testing may be

---

the time a reopening is priced, dealers, traders, and investors have arranged their affairs in reliance on the issue coming to market, and the issuer has earmarked the proceeds for use in its business. In addition, many of the participants have arranged hedges and other transactions around the reopening. In those cases in which the second yield test would not be met (which could be caused by unexpected market volatility), a cancelled reopening could generate lost economic costs for those capital market participants. In addition, the second test would create marketing and credibility concerns for issuers.").

[20] See Treas. Reg. § 1.1275-2(k)(3)(iii)(B) (2001), supra note 5, at 910 (requiring Actual Issue Price Testing for purposes of the De Minimis OID Test). The 2012 Final Regulations take the same approach. See Treas. Reg. §§ 1.1275-2(k)(3)(ii)(C), -2(k)(3)(iii)(B) and -2(k)(3)(iv) (allowing Announcement Date Value Testing for purposes of the 110% Yield Test and the 100% Yield Test but not for purposes of the De Minimis OID Test).

[21] See Treas. Reg. §§ 1.1273-2(c)(1) and -2(d)(1) (rules for determining the issue price of debt instruments that are not publicly traded). As discussed below in Section B of this Part II, Tax Fungibility may be important to the parties even if the debt instruments at issue are not publicly traded.

[22] See Treas. Reg. § 1.1275-2(k)(3)(iii)(A) (2001), supra note 5, at 910; and Treas. Reg. § 1.1275-2(k)(3)(iii)(A).

used for purposes of the De Minimis OID Test. This issue is addressed below in Section B of this Part II.

3. *Should the "Pricing Date" Be Relevant to Announcement Date Value Testing?*

Under the existing rules, the "Pricing Date" (*i.e.*, the date on which the price of the additional debt instruments is established") is relevant to Announcement Date Value Testing in two respects. The Pricing Date is part of the definition of Announcement Date (*i.e.*, the later of (a) seven days before the Pricing Date and (b) the date on which the issuer's intent to do a reopening is publicly announced).[23] The Pricing Date is also used, in some cases, as the reference date for determining the value of the original debt instruments for Announcement Date Value Testing (in lieu of the Announcement Date Value). Both the 2001 Final Regulations and the 2012 Final Regulations apply the Qualified Reopening Tests by reference to the value of the original debt instruments on the Pricing Date or, if earlier, the Announcement Date.[24]

We believe that the first usage of the Pricing Date described above is appropriate but that the second usage is not.

The existing definition of Announcement Date sensibly allows an issuer to rely on the Announcement Date Value (in lieu of the Actual Issue Price) only if pricing occurs within seven days of the public announcement of the reopening. Without a seven day limitation tied to the Pricing Date (*i.e.*, if the Announcement Date were defined simply as the date on which the issuer publicly announces its intent to do a reopening), an issuer could rely indefinitely on a favorable trading value of the original debt instruments on a particular date by publicly announcing on such date that the issuer intends to do a reopening at some time in the future. While the seven day limitation should be retained, we recommend that the definition of Pricing Date be changed to make Announcement Date Value Testing better suited for additional debt instruments issued in exchange offers or as consideration for the acquisition of property.

In contrast, the second usage of the Pricing Date described above should be eliminated. Announcement Date Value Testing is intended to provide certainty at the inception of the reopening process. To achieve this purpose, Announcement Date Value Testing should, in all cases, be applied by reference to the Announcement Date Value (*i.e.*, the value of the original debt instruments as of the Announcement Date), not the value of the original debt instruments as of the Pricing Date or, if earlier, the Announcement Date.

The foregoing changes are discussed in more detail below in Section B of this Part II.

---

23 See Treas. Reg. § 1.1275-2(k)(2)(iv).

24 See Treas. Reg. § 1.1275-2(k)(3)(ii)(C) (2001), supra note 5 at 910 (110% Yield Test); and Treas. Reg. §§ 1.1275-2(k)(3)(ii)(C) (110% Yield Test), -2(k)(3)(iv) (non-publicly traded debt issued for cash) and -2(k)(3)(v) (100% Yield Test).

4. *Is There Any Reason to Restrict The Availability of Actual Issue Price Testing?*

While issuers (and other market participants) will generally prefer Announcement Date Value Testing over Actual Issue Price Testing (because of the upfront certainty that Announcement Date Value Testing provides), there is no reason to restrict an issuer from utilizing Actual Issue Price Testing if the issuer chooses to do so or is unable to utilize Announcement Date Value Testing (*e.g.*, because the original debt instruments do not satisfy the Public Trading Requirement).

In every case, the most accurate way to measure the amount of Holder OID that would be converted to market discount by allowing qualified reopening treatment is to apply the Qualified Reopening Tests by reference to the Actual Issue Price (which would have been the issue price of the additional debt instruments absent qualified reopening treatment). Accordingly, Actual Issue Price Testing should always be permitted (for purposes of all three Qualified Reopening Tests), regardless of whether the additional debt instruments are issued for cash, publicly traded property or non-traded property, and regardless of whether the original debt instruments satisfy the Public Trading Requirement.[25]

The 2012 Final Regulations mandate Actual Issue Price Testing for purposes of the De Minimis OID Test but otherwise prohibit Actual Issue Price Testing except in the case of certain additional debt instruments issued for cash to unrelated parties. As discussed below in Section B of this Part II, we recommend that this rule be changed.

B. Recommended Changes With Respect to Announcement Date Value Testing

We recommend the following changes with respect to Announcement Date Value Testing:

1. *Announcement Date Value Testing Should Be Permitted for All Three Qualified Reopening Tests*

The policy underlying Announcement Date Value Testing (*i.e.*, to protect issuers (and other market participants) against market fluctuations during the reopening process) is equally applicable regardless of which Qualified Reopening Test applies. The 2012 Final Regulations currently permit Announcement Date Value Testing only for purposes of the 110% Yield Test and the 100% Yield Test.[26] We recommend that Announcement Date Value Testing also be permitted for purposes of the De Minimis OID Test.

---

[25] As discussed above, the Public Trading Requirement does serve an important function in the case of Announcement Date Value Testing.

[26] See Treas. Reg. §§ 1.1275-2(k)(3)(iii)(B) and (k)(3)(iv) (Actual Issue Price Testing is required for purposes of the De Minimis OID Test).

2. *To Benefit From Announcement Date Value Testing, an Issuer Needs to Know, Prior to the Announcement Date, What the Announcement Date Value Is and Whether the Public Trading Requirement Will Be Satisfied*

To benefit from Announcement Date Value Testing, an issuer needs to know, prior to the Announcement Date, what the Announcement Date Value is and whether the Public Trading Requirement will be satisfied.

We therefore recommend that the Announcement Date Value be measured as of the last business day preceding the Announcement Date, rather than as of the Announcement Date.[27] The current approach creates a practical impediment to using Announcement Date Value Testing because announcements of debt issuances (including reopenings) frequently need to occur in the morning (before markets open for trading) and the value of a debt instrument as of a particular date generally cannot be determined until the end of trading on such date.[28] Measuring the Announcement Date Value as of the last business day preceding the Announcement Date would solve this problem.

Similarly, whether the Public Trading Requirement is satisfied should, for this purpose, be determined by reference to the 15 day period ending on the last business day preceding the Announcement Date. The 31 day period that generally applies (*i.e.*, the 31 day period ending 15 days after the issue date)[29] does not provide certainty prior to the Announcement Date.

3. *The Rules for Determining the Announcement Date Value Should Reflect the Fact That Publicly Traded Debt Instruments Often Do Not Trade with the Same Liquidity and Transparency as Publicly Traded Stocks*

The rules for determining the Announcement Date Value should reflect the fact that publicly traded debt instruments often do not trade with the same liquidity and transparency as publicly traded stocks. Many debt instruments that are publicly traded for U.S. federal income tax purposes trade exclusively in over-the-counter markets for which trading information is unavailable or limited. There is no system for publicly disseminating trading information with respect to bank loans, and only limited public dissemination of trading information with respect to bonds.[30] An issuer may have limited information regarding the value of a debt instrument, such

---

[27] Cf. Treas. Reg. § 1.368-1(e)(2)(i), which permits the continuity of interest requirement in a corporate reorganization to be satisfied based on the value of the acquirer's stock on the last business day before the date on which the acquisition agreement becomes binding.

[28] Cf. Treas. Reg. § 25.2512-2(a) (for gift tax purposes, the fair market value of a traded security on the date of a gift is generally determined by reference to the mean trading price on such date).

[29] See Treas. Reg. § 1.1273-2(f)(1).

[30] While dealers and brokers generally are required to report over-the-counter trading activity in bonds to the Financial Industry Regulatory Authority ("FINRA"), there are a number of reporting exceptions. Moreover, in general, FINRA publicly disseminates the trading information that FINRA receives (through FINRA's Trade Reporting and Compliance Engine ("TRACE")) only in the case of bonds that are registered with the Securities and Exchange Commission.

as the trading activity (or the current bid and ask prices) of a particular market maker to which the issuer has access or an indicative quote of a dealer, broker or pricing service.[31]

In the Public Trading Regulations, Treasury acknowledged the challenge of valuing publicly traded debt instruments by including rules (in Treas. Reg. § 1.1273-2(f)(5)) to assist issuers in valuing debt instruments when there is limited pricing information. When the available pricing information is not entirely consistent, those rules permit the issuer to determine the value of a debt instrument "using any reasonable method, consistently applied to the same or similar facts." We recommend the same approach for determining the Announcement Date Value.

4. *The Announcement Date Value Should Always Be Determined by Reference to the Original Debt Instruments*

The Announcement Date Value must be determined by reference to the original debt instruments. The provisions of the 2012 Final Regulations that address the 100% Yield Test currently provide for Announcement Date Value Testing based on the yield of the additional debt instruments,[32] even though, as of the Announcement Date, the additional debt instruments have neither been issued nor priced. We recommend that this rule be changed.

5. *The Qualified Reopening Tests Should Apply the Announcement Date Value as of the Reopening Date, Not the Announcement Date*

As discussed above, the purpose of Announcement Date Value Testing is to protect the issuer (and other market participants) from market fluctuations during the reopening process. That is why Announcement Date Value Testing refers to the Announcement Date Value rather than the Actual Issue Price. But the Qualified Reopening Tests should apply the Announcement Date Value as of the actual issue date of the additional debt instruments, determined without regard to the qualified reopening rules (the "Reopening Date"), not the Announcement Date. Testing as of the Announcement Date would distort the Qualified Reopening Tests by treating the reopening as occurring earlier than it actually occurs.

Consider the following example. In late December 2019, an Issuer wishes to reopen a tranche of publicly traded original debt instruments (the "original bonds") that mature on December 31, 2025. The original bonds were issued at par on December 31, 2017. All interest payable on the original bonds qualifies as "qualified stated interest" (within the meaning of Treas. Reg. § 1.1273-1(c)). Principal repayment is required only at maturity (*i.e.*, no amortization of principal is required or permitted).

The only Qualified Reopening Test that may help in this example is the De Minimis OID Test. The threshold price for satisfying the De Minimis OID Test will depend on whether the reopening will be completed in 2019. If the Reopening Date is in 2019, the De Minimis OID Test

---

[31] See Treas. Reg. § 1.1273-2(f)(9) (a debt instrument will be considered publicly traded for this purpose if, at any time during the applicable 31 day testing period, there are sales prices, firm quotes or indicative quotes for the debt instrument).

[32] See Treas. Reg. § 1.1275-2(k)(3)(v).

will be satisfied at a price of 98.51[33] or higher.[34] If the Reopening Date is in 2020, the De Minimis OID Test will require a price of 98.76 or higher.[35]

On December 23, 2019, the Issuer publicly announces its intent to reopen the original bonds. The Announcement Date Value is 98.63. The additional bonds price at 98.37 on December 26, 2019. Assume, in the alternative, that: (1) the Reopening Date is December 31, 2019; (2) the Reopening Date was expected to be December 31, 2019 but is unexpectedly delayed until January 2, 2020; or (3) the Reopening Date, as anticipated from the inception of the reopening process, is January 2, 2020.

We believe that the reopening in scenario (1) should be a qualified reopening. The issuer (and other market participants) should be permitted to rely on Announcement Date Value Testing for purposes of satisfying the De Minimis OID Test. Had the additional bonds actually been issued at a price equal to the Announcement Date Value (98.63), the additional bonds would have satisfied the De Minimis OID Test based on Actual Issue Price Testing. Announcement Date Value Testing is intended to protect against a decline in the value of the bonds after the Announcement Date.

In contrast, the reopening in scenario (3) should not be a qualified reopening. Announcement Date Value Testing should not allow the issuer to deem the additional bonds to have been issued earlier than the Reopening Date (January 2, 2020) and thereby increase the threshold for satisfying the De Minimis OID Test. Had the additional bonds priced at 98.63 (the Announcement Date Value) on the Reopening Date, the reopening would not have been a qualified reopening based on Actual Issue Price Testing. The reopening failed to be a qualified reopening because the additional bonds were not issued until 2020, not because of a decline in the value of the bonds after the Announcement Date.

Scenario (2) is the same as scenario (3) except that the issuance of the additional bonds occurred in 2020 due to unexpected delay. Unless the purpose of Announcement Date Value Testing includes protecting the issuer (and other market participants) against delays in the reopening process, the reopening in scenario (2), like the reopening in scenario (3), should not be a qualified reopening. We believe that is the correct result.

---

[33] Unless otherwise indicated, the price of a debt instrument (*e.g.*, 98.51) represents a percentage of the stated principal amount of such debt instrument.

[34] Holder OID will be considered de miminis if the total amount of Holder OID is less than the product of (a) one quarter of one percent and (b) the number of complete years remaining until maturity of the bonds. See Section 1273(a)(3). If the reopening occurs in 2019, there will be six full years remaining until maturity and Holder OID of less than 1.50 (*i.e.*, .25 x six full years remaining) will be considered de minimis.

[35] If the reopening occurs in 2020, there will be only five full years remaining until maturity and the Holder OID will have to be less than 1.25 (*i.e.*, .25 x five full years remaining) to be considered de minimis.

The foregoing issue is illustrated most clearly in the case of the De Minimis OID Test (because the threshold price for satisfying the De Minimis OID Test increases by 25 basis points once a year on a particular date). However, although the impact is less pronounced for the 110% Yield Test and the 100% Yield Test, the issue remains the same.

Accordingly, we recommend that the Qualified Reopening Tests apply the Announcement Date Value as of the Reopening Date, not the Announcement Date.

6. *Announcement Date Value Testing Should Be Permitted Even if There Is No Public Announcement of the Reopening*

Announcement Date Value Testing should be permitted even if there is no public announcement of the issuer's intent to do the reopening. An issuer of publicly traded original debt instruments may wish to do a reopening that is not announced publicly (*e.g.*, a private placement). In those situations, an issuer and other market participants still need certainty at the inception of the reopening process that qualified reopening status can be achieved. If there is no public announcement of a reopening, a question arises under the existing definition of Announcement Date as to whether there is an Announcement Date (or what the Announcement Date is). While an issuer may, in some cases, ensure that there is an Announcement Date by announcing the transaction publicly, there may be instances in which, for confidentiality or other non-tax reasons, an issuer is unable or unwilling to make a public announcement.

We recommend that the definition of Announcement Date be clarified to provide that, if there is no public announcement of an issuer's intent to do a reopening, the Announcement Date will be the date that is seven days before the Pricing Date.[36] While such a rule would not always provide certainty at the inception of the reopening process (because, at such time, the issuer may not yet know which date will be exactly seven days before the Pricing Date), the rule would provide certainty in many cases. For example, if the value of the original debt instruments has exceeded the threshold for qualified reopening status for seven consecutive days, an issuer can then commence a reopening process with assurance that, if the reopening can be priced at any time within the next seven days, the reopening will be a qualified reopening.

7. *A Public Announcement of a Reopening Should Be Relevant only if the Announcement Occurs Prior to the Pricing Date*

A public announcement of a reopening should be relevant only if the announcement occurs prior to the Pricing Date. If the announcement does not occur prior to the Pricing Date, the Announcement Date should be the date that is seven days before the Pricing Date (which is the same definition of Announcement Date that we recommend above for reopenings that are not publicly announced).

[36] If there is a public announcement of the issuer's intent to do a reopening, the existing definition of Announcement Date would still apply (*i.e.*, the later of (a) seven days before the Pricing Date and (b) the date of the announcement), subject to the recommendation below when the announcement is not made prior to the Pricing Date.

Consider the following example. In December 2019, an issuer wishes to reopen a tranche of publicly traded bonds that were issued at par in 2016 (the "2016 bonds"). The 2016 bonds mature on December 31, 2023. Accordingly, the De Minimis OID Test will be satisfied at a price of 99.01 or higher.[37]

On December 2, 2019, the issuer prices a reopening of the 2016 bonds at less than 99.01. The reopening is expected to close on December 6, 2019. As of the Pricing Date (December 2, 2019), the 2016 bonds have been trading below 99.01 throughout the prior seven day period. Accordingly, as of December 2, 2019, the reopening would not be treated as a qualified reopening under Announcement Date Value Testing or Actual Issue Price Testing.

On December 4, 2019, the trading price of the 2016 bonds improves to a level above 99.01. Under the existing definition of Announcement Date (*i.e.*, the later of (a) seven days before the Pricing Date and (b) the date of the public announcement), the issuer could make December 4, 2019 the Announcement Date by publicly announcing the reopening on that date.

An issuer should not be allowed to change the result of Announcement Date Value Testing by publicly announcing a reopening after the reopening has priced. We recommend that the definition of Announcement Date be clarified to address this issue.

8. *The Role of the Pricing Date Should Be Changed*

As discussed above in Section A of this Part II, we recommend that Announcement Date Value Testing be applied, in all cases, by reference to the Announcement Date Value (not the value of the original debt instruments as of the Pricing Date or, if earlier, the Announcement Date).

The purpose of Announcement Date Value Testing is to provide certainty at the inception of the reopening process as to whether a reopening will be a qualified reopening. Applying Announcement Date Value Testing by reference to the value of the original debt instruments as of the Pricing Date provides no such certainty and, in many cases (including any offering of additional debt instruments for cash), provides no benefit at all relative to Actual Issue Price Testing (because the Actual Issue Price will be known by the Pricing Date).

We also recommend that the reference to the Pricing Date be retained in the definition of Announcement Date (*i.e.*, the later of (a) seven days before the Pricing Date and (b) the date on which the issuer's intent to do a reopening is publicly announced[38]). This definition sensibly allows an issuer to rely on the Announcement Date Value (in lieu of the Actual Issue Price) only if pricing occurs within seven days of the public announcement of the reopening. But, as described below, we recommend that the definition of Pricing Date be changed to make Announcement

---

[37] Holder OID will be considered de minimis in this example if the total amount of Holder OID is less than 1.00 (*i.e.*, less than the product of (a) .25 and (b) four full years remaining until maturity). See Section 1273(a)(3).

[38] See Treas. Reg. § 1.1275-2(k)(2)(iv).

Date Value Testing better suited for additional debt instruments issued in exchange offers or as consideration for the acquisition of property.

Except as provided in the next sentence, the Pricing Date should be the first date on which the Actual Issue Price can be determined. If, however, the additional debt instruments (1) are being offered pursuant to an exchange offer with fixed commercial terms or (2) are to be issued as consideration for an acquisition of property pursuant to an agreement (with fixed commercial terms) that will not sign and close simultaneously, the Pricing Date will be the date on which the exchange offer is launched or the acquisition agreement is signed (as applicable), provided that the commercial terms of the issuance (including the consideration to be received in exchange for such issuance) do not change materially[39] and the Reopening Date occurs within a brief time period thereafter. We recommend a period of 45 days plus a reasonable and customary settlement period (*i.e.*, that the Reopening Date must occur no later than the end of such period), to accommodate exchange offers and acquisitions that require routine antitrust review.[40]

This definitional change to the Pricing Date will have no effect on any offering of additional debt instruments for cash. But the special rule for additional debt instruments issued in certain exchange offers and acquisitions will provide certainty that qualified reopening status will not be disrupted by market fluctuations in the original debt instruments after an exchange offer has launched or an acquisition agreement has been signed (in the same way that Announcement Date Value Testing protects the parties from market fluctuations between the Announcement Date and the Pricing Date).

Consider the following example. An Issuer of a tranche of publicly traded original debt instruments issued on June 30, 2018 (the "original 2018 bonds") wishes to issue additional 2018 bonds (the "additional 2018 bonds") in an exchange offer for another tranche of the Issuer's outstanding bonds. The original 2018 bonds were issued at par and mature on June 30, 2025. All interest payable on the original 2018 bonds qualifies as "qualified stated interest" (within the meaning of Treas. Reg. § 1.1273-1(c)). Principal repayment is required only at maturity (*i.e.*, no amortization of principal is required or permitted).

The Issuer publicly announces its intention to pursue the exchange offer on December 1, 2019 and launches the exchange offer (with fixed commercial terms) on December 5, 2019 (*i.e.*, no more than seven days after the announcement), The value of the original 2018 bonds on December 1, 2019 is 98.76 or higher (*i.e.*, high enough to satisfy the De Minimis OID Test). Under applicable securities laws, the exchange offer must remain open for 20 business days. As a result of market fluctuations in the original 2018 bonds after the public announcement of the exchange

[39] If there are material changes to the commercial terms, a new Announcement Date and Pricing Date can be determined by reference to the date on which the revised commercial terms become fixed.

[40] Under current securities law, exchange offers generally are required to remain open for at least 20 business days. A routine antitrust review of an acquisition generally involves a 30 day waiting period that typically commences within several days after the acquisition agreement is signed.

offer, the Actual Issue Price, and the value of the original 2018 bonds seven days before the closing date of the exchange offer, are below the threshold for satisfying the De Minimis OID Test (*i.e.*, 98.75 or lower).

If the Pricing Date were redefined as recommended above, the Announcement Date would be December 1, 2019 (*i.e.*, the later of (a) seven days before the date on which the commercial terms of the exchange offer became fixed and (b) the date on which the reopening was publicly announced) and the Issuer would have certainty on the Announcement Date that the additional 2018 bonds would be a qualified reopening (regardless of the Actual Issue Price, which, in this situation, cannot be determined until the closing date of the exchange offer). As the rules are currently written, if the Pricing Date is interpreted as the first date on which the Actual Issue Price can be determined (which we believe to be the prevailing interpretation), the Announcement Date would be seven days before the closing date of the exchange offer and the additional 2018 bonds would fail the De Minimis OID Test under either Announcement Date Value Testing or Actual Issue Price Testing.

The uncertainty under the existing rules requires issuers pursuing exchange offers to disclose to holders (at the time of launch) that the exchange offer may be canceled (shortly before the scheduled closing date) due to a lack of Tax Fungibility.

Our revised definition of Pricing Date would accommodate exchange offers and acquisitions that close relatively quickly, but would not apply where there is a significant time lag between launch (or signing) and closing (*e.g.*, where the additional debt instruments are to be issued as consideration for an acquisition that will not close until months after signing).

9. *An Issuer Should Be Permitted to Reannounce a Reopening if There Is a Non-Tax Purpose for Doing So*

An issuer should be permitted to reannounce a reopening if there is a non-tax purpose for doing so.

Assume that an issuer announces a reopening of bonds on day one, when the trading price of the original bonds is sufficiently high to satisfy the Qualified Reopening Tests. On day one, the issuer expects the reopening to price by day eight and therefore expects to rely on the day one trading value as the Announcement Date Value. On day three, market conditions require the reopening to be postponed. On a later date when market conditions improve, the issuer resumes the reopening process. But, as a result of the delay, the reopening will no longer price by day eight.

Can the issuer reannounce the reopening to lock in a new Announcement Date Value for a new seven day period? The existing rules are silent on this point. We recommend that, if there is a non-tax purpose for reannouncing a reopening (*e.g.*, to alert the market that a reopening process that was postponed due to market conditions has resumed), an issuer should be permitted to reannounce the reopening and lock in a new Announcement Date Value for a new seven day period.

C. Recommended Changes With Respect to Actual Issue Price Testing

We recommend the following changes with respect to Actual Issue Price Testing:

1. *Expand the Availability of Actual Issue Price Testing*

The 2012 Final Regulations currently permit Actual Issue Price Testing only in situations in which the additional debt instruments are issued for cash to parties unrelated to the issuer (as determined under Sections 267(b) and 707(b) of the Code) for an arm's-length price,[41] or for purposes of the De Minimis OID Test. As discussed above in Section A of this Part II, Actual Issue Price Testing is always an accurate testing methodology because the actual amount of Holder OID that would have existed absent qualified reopening treatment will always be determined by reference to the Actual Issue Price. Accordingly, we recommend that Actual Issue Price Testing be permitted in all cases, including reopenings in which (1) a substantial amount of the additional debt instruments is issued for money,[42] (2) a substantial amount of the additional debt instruments is publicly traded,[43] (3) a substantial amount of the additional debt instruments is issued for property that is publicly traded (including additional debt instruments issued for foreign currency)[44] or (4) neither the additional debt instruments nor the consideration issued in exchange therefor is publicly traded and the Actual Issue Price of the additional debt instruments is determined under Sections 1273(b)(4) or 1274 of the Code.[45]

2. *The Testing Date for Actual Issue Price Testing Should Always Be the Reopening Date*

The Testing Date for Actual Issue Price Testing should always be the Reopening Date because testing as of the Reopening Date accurately measures the actual amount of Holder OID that would have existed absent the qualified reopening rules. The 2012 Final Regulations provide that the Testing Date for Actual Issue Price Testing with respect to arm's length cash offerings to unrelated parties is the Pricing Date (or, if earlier, the Announcement Date).[46] There is no reason to use the Pricing Date or the Announcement Date for Actual Issue Price Testing. Actual Issue Price Testing is intended to provide accuracy, not upfront certainty. Moreover, the use of an earlier Testing Date provides no upfront certainty because, in any event, Actual Issue Price Testing cannot be done until the Actual Issue Price has been determined.

---

[41] See Treas. Reg. § 1.1275-2(k)(3)(iv). The heading of that paragraph ("*Non-publicly traded debt issued for cash*") suggests that Actual Issue Price Testing may be further limited to cash offerings of non-publicly traded debt.

[42] See Treas. Reg. § 1.1273-2(a)(1).

[43] See Treas. Reg. § 1.1273-2(b)(1).

[44] See Treas. Reg. § 1.1273-2(c)(1).

[45] See Treas. Reg. § 1.1273-2(d)(1). Under the current qualified reopening rules, additional debt instruments described in clauses (3) or (4) can never be issued in a qualified reopening (because the Public Trading Requirement will not be satisfied and such debt instruments are not issued for cash). While commercial fungibility typically may be less significant for these categories of debt instruments (because the original debt instruments are not publicly traded), commercial fungibility may still be important (*e.g.*, if the issuer and holders envision trading at some point in the future).

[46] See Treas. Reg. §§ 1.1275-2(k)(3)(iv) and (v).

III. Recommended Changes to the Qualified Reopening Rules to Address Variable Rate Debt Instruments and Other Debt Instruments with Fluctuating Yields

This Part III provides recommendations for updating the 100% Yield Test and the 110% Yield Test (the "Yield Tests") to address variable rate debt instruments ("VRDIs") and other debt instruments with yields that may fluctuate without resulting in a deemed reissuance of such debt instruments for purposes of Treas. Reg. § 1.1001-3 ("Fluctuating Yield Debt Instruments").

A. The Existing Yield Tests Are Not Well Suited for Fluctuating Yield Debt Instruments

Under existing law. both Yield Tests refer to the yield of the original debt instruments at the time of their issuance.[47] While this approach generally works well for a fixed rate debt instrument with a yield that remains constant throughout the term of such instrument (a "Constant Yield Debt Instrument"), such approach is not well suited for Fluctuating Yield Debt Instruments. For example, if a VRDI yields six percent at issuance but, due to interest rate changes, yields eight percent at the time of a proposed reopening, it is inappropriate to apply the Yield Tests by reference to the initial six percent yield. The same issue arises for other Fluctuating Yield Debt Instruments, including, as described below, "PIK Toggle Notes," debt instruments with a "MFN Provision" and debt instruments with respect to which certain consensual amendments have been made:

1. *PIK Toggle Notes*

A "PIK Toggle Note" is a note that permits the issuer to elect, with respect to each interest period (or specified interest periods during the term of the note), to pay interest either in cash or in additional notes ("PIK Payments"). To incentivize an issuer to pay interest in cash, PIK Toggle Notes often provide a lower interest rate for cash interest.

Assume that a PIK Toggle Note issued at par provides the issuer with an unconditional option to pay interest either in cash at a rate of six percent or in PIK Payments at a rate of seven percent. Pursuant to the option rule of Treas. Reg. § 1.1272-1(c)(5) (the "Option Rule"), because the issuer can lower the yield of such note by paying interest in cash, it initially will be assumed, for purposes of determining the yield and OID with respect to such note, that the issuer will pay all interest in cash. Thus, the yield of such PIK Toggle Note, as of its issue date, would be six percent.

If, contrary to the foregoing assumption, the issuer elects to pay any interest in PIK Payments, the PIK Toggle Note would be treated, <u>solely for purposes of computing the yield and OID of the PIK Toggle Note going forward,</u>[48] as having been retired and reissued for an amount equal to the adjusted issue price of the PIK Toggle Note at such time. Thus, each time the issuer

---

[47] <u>See</u> Treas. Reg. § 1.1275-2(k)(3)(ii)(C) (110% Yield Test applies to "the yield of the original debt instruments on their issue date") and Treas. Reg. § 1.1275-2(k)(3)(v) (same approach for the 100% Yield Test).

[48] <u>See</u> Treas. Reg. §§ 1.1272-1(c)(6) and -1(j) (Example 7).

exercises its option to pay interest in PIK Payments, the yield of the PIK Toggle Note will increase[49] but there will be no deemed reissuance of the PIK Toggle Note for purposes of Treas. Reg. § 1.1001-3 (a "Deemed Reissuance").[50]

2. *Debt Instruments with a Most Favored Nation Provision (a "MFN Provision")*

A MFN Provision is a common provision in bank loans. A MFN Provision in a bank loan generally provides that, if the issuer issues other specified debt within a specified time period after issuance of the bank loan and the yield of the other debt exceeds the yield of the bank loan by more than a threshold amount (*e.g.*, 50 basis points), the yield of the bank loan will automatically increase (typically through an increase in the stated interest rate) to reduce the disparity in yield between the other debt and the bank loan to the threshold amount.

For example, assume that a bank loan is issued at par with a stated interest rate of LIBOR plus 500 basis points. The bank loan has a MFN Provision with a threshold amount of 50 basis points. One year later, the issuer enters into a second bank loan, at par, with a stated interest rate of LIBOR plus 600 basis points. The MFN Provision would cause the stated interest rate of the initial bank loan to increase automatically to LIBOR plus 550 basis points.

An increase in the yield of a bank loan pursuant to a MFN Provision generally will not result in a Deemed Reissuance of such loan.[51]

3. *Consensual Modifications That Are Not "Significant"*

Consensual modifications of a debt instrument that are not "significant" (within the meaning of Treas. Reg. § 1.1001-3(e)) may change the yield of a debt instrument without resulting in a Deemed Reissuance of the debt instrument.

Assume that an issuer of notes is seeking consent of the holders to amend customary financial covenants. The notes were issued at par with an interest rate of six percent. As consideration for the amendment, the issuer agrees to increase the stated interest rate on the notes by 25

---

[49] The yield of the PIK Toggle Note will increase, even though it will continue to be assumed (pursuant to the Option Rule) that the issuer will pay only cash interest going forward, because the PIK Payment will increase the principal amount due at maturity and, correspondingly, the amount of interest payable with respect to each interest period.

[50] The resulting increase in yield (and payment deferral) would not result in a "modification" of the PIK Toggle Note for purposes of Treas. Reg.§ 1.1001-3 because the issuer's option is a term of the PIK Toggle Note and is a "unilateral option" that may be exercised by the issuer without the consent of the holders. See Treas. Reg. §§ 1.1001-3(c)(1)(ii), (c)(2)(iii) and (c)(3).

[51] See Treas. Reg. § 1.1001-3(c)(1)(ii) (an alteration of a debt instrument that occurs automatically pursuant to the terms of the debt instrument is not a "modification").

basis points (to 6.25% per annum). No consent fee or other consideration is paid for the amendment. The yield of the notes has increased but there will be no Deemed Reissuance of the notes.[52]

B. Recommended Changes to Address Fluctuating Yield Debt Instruments

We recommend (as discussed in more detail below) that, in all cases (including for Constant Yield Debt Instruments), (1) the 100% Yield Test be replaced with a new test based on the adjusted issue price of the original debt instruments and (2) for purposes of the 110% Yield Test, the yield of the original debt instruments should be measured as of the Reopening Date, rather than as of their issue date. We also discuss how the 10% yield cushion in the 110% Yield Test (*i.e.*, the excess of 110% of the applicable yield over 100% of the applicable yield (the "10% Yield Cushion")) should be determined for a Fluctuating Yield Debt Instrument and suggest two possible alternatives.[53]

1. *The 100% Yield Test Should Be Replaced by an Adjusted Issue Price Test*

We recommend that, in all cases (including for Constant Yield Debt Instruments), the 100% Yield Test be replaced by an adjusted issue price test that will treat a reopening as a qualified reopening if the Announcement Date Value or Actual Issue Price, as applicable, is no less than the adjusted issue price of the original debt instruments as of the Reopening Date (the "Adjusted Issue Price Test").

While the 110% Yield Test was designed to depend on the yield of the original debt instruments, the 100% Yield Test was based on a different rationale and need not be formulated as a yield test.

The 110% Yield Test (one of the two original Qualified Reopening Tests that were created in 2001) permits some conversion of Holder OID into market discount and, therefore, may be used only during the first six months after issuance of the original debt instruments. Treasury expressly tied the maximum level of Holder OID that could be converted to market discount to the yield of the original debt instruments. In each case, conversion of Holder OID is permitted only if the additional yield represented by the converted OID does not exceed 10 percent of the yield of the original debt instruments.

---

[52] The increase in yield is not "significant" because the increase does not exceed the greater of (1) 25 basis points and (2) five percent of the yield of the notes prior to the modification (*i.e.*, 30 basis points). See Treas. Reg. § 1.1001-3(e)(2). The covenant changes are also deemed not to be significant. See Treas. Reg. § 1.1001-3(e)(6) (a modification that adds, deletes, or alters customary accounting or financial covenants is not a significant modification).

[53] For reopenings within six months of the issuance of the original debt instruments, the 10% Yield Cushion represents the amount of Holder OID that Treasury will allow to be converted into market discount.

In contrast, the 100% Yield Test (which was added as a new Qualified Reopening Test by the 2012 Final Regulations) may be used at any time during the term of the original debt instruments because, like the De Minimis OID Test, the 100% Yield Test is intended to prevent any conversion of Holder OID.[54] The 100% Yield Test is premised on the fact that, if the test is satisfied, no conversion of Holder OID is possible because the deemed issue price of the additional debt instruments that would result from qualified reopening treatment would be no higher than the Actual Issue Price. That will be true, regardless of the yield of the original debt instruments, in any case in which the Actual Issue Price is no less than the adjusted issue price of the original debt instruments as of the Reopening Date.[55]

The current 100% Yield Test works fine for Constant Yield Debt Instruments (because, for such debt instruments, a 100% Yield Test and an Adjusted Issue Price Test are effectively the same test) and, at the time the 2012 Final Regulations were issued, reopenings generally were limited to Constant Yield Debt Instruments (*i.e.*, fixed rate bonds). But since that time, as discussed in Part I of this Report, reopenings have become much more common for Fluctuating Yield Debt Instruments, such as bank loans (which typically are VRDIs). An Adjusted Issue Price Test would work well for both Constant Yield Debt Instruments and Fluctuating Yield Debt Instruments and would eliminate the need for unnecessary yield computations.[56]

To ensure that the Adjusted Issue Price Test works as intended to prevent any conversion of Holder OID into market discount, the adjusted issue price of the original debt instruments should be determined, for purposes of this test, without regard to the rules governing de minimis Holder OID. Thus, for this purpose, the adjusted issue price of the original debt instruments on the Reopening Date would take into account all accrued OID with respect to such instruments (including de minimis OID that holders are not required to accrue into income), based on a constant yield method.[57]

---

[54] See Preamble to Treas. Reg. § 1.1275-2(k), supra note 16, at 419 ("Commenters requested that the qualified reopening rules in § 1.1275-2(k) be further liberalized. In response to these comments, the final regulations expand the definition of a qualified reopening to include an issuance that satisfies a 100 percent yield test for a reopening after six months. This change is consistent with the intent of the reopening rules, which prevent taxpayers from converting OID into market discount."). See also NYSBA Tax Section Report No. 1237, supra note 3, at 22 (recommending a new 100% Yield Test because such test "would provide issuers with greater flexibility to reopen a debt offering outside the six month window without any potential for converting OID on the additional debt instruments into market discount.").

[55] See Treas. Reg. § 1.1275-2(k)(1) (additional debt instruments issued in a qualified reopening "have the same issue date, the same issue price, and (with respect to holders) the same adjusted issue price as the original debt instruments") (emphasis added).

[56] Applying a 100% Yield Test based on the yield of the original debt instruments as of the Reopening Date would simply confirm, in every case, that the threshold price for satisfying the 100% Yield Test is the adjusted issue price of the original debt instruments as of the Reopening Date.

[57] Cf. Treas. Reg. § 1.1275-1(b)(1) (the generally applicable definition of adjusted issue price), which takes into account only OID includible in the income of holders.

2. *For purposes of the 110% Yield Test, the Yield of the Original Debt Instruments Should Be Measured as of the Reopening Date (Rather Than as of their Issue Date), Taking Into Account Any Changes to the Stated Interest Rate that Occur in Connection With the Reopening*

For purposes of the 110% Yield Test, the yield of the original debt instruments should be measured as of the Reopening Date (based on their adjusted issue price on such date), rather than as of their issue date.

While the current formulation of the 110% Yield Test (which measures the yield of the original debt instruments as of their issue date) works well for Constant Yield Debt Instruments (because their yields never change), a revised 110% Yield Test that measures the yield as of the Reopening Date would work equally well. Accordingly, we recommend that the revised 110% Yield Test apply in all cases, including for Constant Yield Debt Instruments.

The yield as of the Reopening Date should take into account any changes to the stated interest rate that occur in connection with the reopening. For example, many VRDIs permit an issuer to vary the applicable variable interest rate (*e.g.*, one-month LIBOR versus three-month LIBOR or six-month LIBOR) over the term of the debt instrument. In connection with a reopening, the issuer will typically elect to reset the applicable variable interest rate on the original debt instruments to match the new applicable variable interest rate on the additional debt instruments. A reopening also may trigger the application of a MFN Provision with respect to the original debt instruments (as discussed above). For any debt instruments (including Fluctuating Yield Debt Instruments), the relevant yield for purposes of applying the 110% Yield Test should be the applicable yield of the original debt instruments immediately after the reopening (taking into account any resulting changes in the stated interest rate). In the case of a VRDI, that applicable yield should be determined as if the VRDI were a fixed rate debt instrument (in accordance with the principles of Treas. Reg. § 1.1275-5(e)), based on the applicable variable interest rate(s) in effect immediately after the reopening.

Measuring the yield of Fluctuating Yield Debt Instruments as of the Reopening Date will limit the certainty that Announcement Date Value Testing can provide with respect to such debt instruments (because the yield of such debt instruments as of the Reopening Date may not be determinable until on or shortly before such date).[58] If the actual yield as of the Reopening Date is lower than the anticipated yield as of the Announcement Date, the 10% Yield Cushion (*i.e.*, the amount of Holder OID that Treasury will allow to be converted into market discount) will be smaller than anticipated. But, in many cases, this lack of certainty will not be a practical impediment because qualified reopening treatment will be assured absent a significant decline in interest rates between the Announcement Date and the Reopening Date. Moreover, while a special version of Announcement Date Value Testing could be devised for Fluctuating Yield Debt Instruments, we believe that, as a policy matter, Announcement Date Value Testing should, in all

[58] For example, if a variable interest rate is to be reset as of the Reopening Date, the actual interest rate generally will not be determinable until two business days prior to such date. Similarly, the effect, if any, of a MFN Provision applicable to bank loans cannot be determined until the price of the additional bank loans has been determined.

cases, be applied in the same manner as Actual Issue Price Testing (except for the use of the Announcement Date Value in lieu of the Actual Issue Price).

3. *Should the 10% Yield Cushion Be Measured By Reference to the Yield as of the Issuance Date, or the Yield as of the Reopening Date?*

Another issue to be considered in updating the 110% Yield Test is whether the 10% Yield Cushion should be measured by reference to the yield as of the issuance date of the original debt instruments or, alternatively, the yield as of the Reopening Date.

Assume that a VRDI issued at par (a) has a yield, as of its issuance date, of eight percent and (b) has a yield, as of a Reopening Date six months after the issue date, of either nine percent or seven percent. As discussed above, the 110% Yield Test should be applied by reference to the yield as of the Reopening Date (either nine percent or seven percent), not the yield as of the issuance date (eight percent). But which yield should apply for purposes of computing the 10% Yield Cushion (*i.e.*, for determining the amount of Holder OID that Treasury will allow to be converted into market discount)?

An argument for measuring the 10% Yield Cushion by reference to the yield of the original debt instruments as of their issuance date is that subsequent interest rate fluctuations are fortuitous and should not affect the level of Holder OID conversion permitted by the 110% Yield Test. Under this approach, the 10% Yield Cushion in the example would be 80 basis points per annum of OID (*i.e.*, 10% of eight percent), regardless of subsequent interest rate fluctuations. If the yield of the foregoing VRDI increased to nine percent as of the Reopening Date, the threshold yield for the 110% Yield Test would be 9.8% (*i.e.*, nine percent plus 80 basis points). If the yield of such VRDI decreased to seven percent as of the Reopening Date, the threshold yield for the 110% Yield Test would be 7.8% (*i.e.*, seven percent plus 80 basis points).

Alternatively, an argument can be made that, if the yield of the original debt instruments changes between their issuance date and the Reopening Date, the 110% Yield Test should apply to such original debt instruments in the same manner as if such debt instruments were fixed rate instruments as of the Reopening Date. Under this approach, if the yield of the foregoing VRDI, as of the Reopening Date, either increased to nine percent or decreased to seven percent, the threshold yield for the 110% Yield Test would be 9.9% (*i.e.*, 110% of nine percent) or 7.7% (*i.e.*, 110% of seven percent), respectively.

We think either approach would be reasonable and would provide clarity to issuers and other market participants.

IV. Other Changes to Address Issues That Arise Frequently in Market Practice

This Part IV recommends other changes to the qualified reopening rules and other rules that affect Tax Fungibility to address issues that arise frequently in market practice.

A. The "Identical Terms Requirement" (in Both the Qualified Reopening Rules and the Definition of Issue) Should Be Replaced With a "Commercial Fungibility" Requirement

As a condition for Tax Fungibility, the qualified reopening rules and the definition of "issue"[59] each require that the additional debt instruments have identical terms to the original debt instruments (the "Identical Terms Requirement"). But the two formulations differ. Treas. Reg. § 1.1275-2(k)(2)(ii)(C), which applies to qualified reopenings, requires that additional debt instruments "have terms that are in all respects identical to the terms of the original debt instruments as of the reopening date." In contrast, Treas. Reg. § 1.1275-1(f)(1)(i), which addresses whether two debt instruments will be considered part of the same issue, requires that the additional debt instruments "[h]ave the same credit and payment terms."

There should be a uniform standard for testing additional debt instruments. If an Identical Terms Requirement is retained, we believe that the formulation in the definition of issue (*i.e.*, the same credit and payment terms) should also apply to qualified reopenings. But we recommend that the Identical Terms Requirement be replaced with a requirement that the additional debt instruments are viewed by holders as commercially fungible, as evidenced by the eligibility of such additional debt instruments, apart from U.S. federal income tax consequences, to trade under the same CUSIP number as the original debt instruments (a "Commercial Fungibility Requirement"). An Identical Terms Requirement does not serve any independent tax purpose and is not a condition of fungibility with respect to instruments other than debt instruments. The other requirements of the qualified reopening rules and the definition of issue are sufficient to limit Tax Fungibility to appropriate situations.

Replacing the Identical Terms Requirement with a Commercial Fungibility Requirement would eliminate uncertainty with regard to "pre-issuance accrued interest," *i.e.*, interest that has accrued on the original debt instruments from the last interest payment date through the Reopening Date. As explained below, while the concept of pre-issuance accrued interest generally is limited to bonds (*i.e.*, does not exist with respect to bank loans), a question arises for reopenings of both bonds and bank loans as to whether the Identical Terms Requirement has been satisfied.

As a commercial matter, pre-issuance accrued interest with respect to a reopening of bonds typically is addressed in the same manner as accrued and unpaid interest on an outstanding bond that is traded between interest payment dates. The purchase price paid by the purchaser will be increased by any accrued and unpaid interest since the last interest payment date (in the case of an outstanding bond trading between interest payment dates) or by any pre-issuance accrued interest (in the case of additional bonds issued in a reopening) and, in each situation, the issuer will then pay a full interest coupon to the purchaser on the next interest payment date.[60]

The foregoing commercial practice allows a reopening of additional bonds that occurs during an interest period of the original bonds to be commercially fungible with the original

[59] Treas. Reg. § 1.1275-1(f)(1).

[60] The purchaser typically treats the accrued and unpaid interest or pre-issuance accrued interest, as applicable, as a tax-free return of the corresponding amount paid by the purchaser at the time of purchase, as opposed to a payment on the bond. See Treas. Reg. §§ 1.61-7(c) and 1.1273-2(m).

bonds from the moment the additional bonds are issued. However, even though the additional bonds are commercially fungible from inception, a question arises as to whether the Identical Terms Requirement has been satisfied (because the additional bonds provide for pre-issuance accrued interest whereas the original bonds provide for an equivalent amount of actual interest).

A similar question arises with respect to bank loans, even though the concept of pre-issuance accrued interest generally does not apply to bank loans (because the parties (typically, the administrative agent) are able to track trading activity in bank loans and pay each lender the interest that accrues during such lender's period of ownership). While an incremental loan generally need not provide for pre-issuance accrued interest to be commercially fungible from inception, a question arises as to whether the Identical Terms Requirement has been satisfied (because the first interest payment on the incremental loan (for the stub interest period) will differ from the concurrent interest payment on the original loans (for the full interest period)).

We therefore recommend that, for purposes of both the qualified reopening rules and the definition of issue, the Identical Terms Requirement be replaced with a Commercial Fungibility Requirement.

B. If a Reopening Is Not Intended To Be Commercially Fungible Until Some Time After the Reopening Date, the Commercial Fungibility Requirement Need Not Be Satisfied Until Such Time

In general, the Commercial Fungibility Requirement should be tested as of the Reopening Date. However, there are situations in which, for non-tax reasons, additional debt instruments initially have some commercial terms that differ from those of the original debt instruments, but the parties expect that, within a limited time period thereafter, the commercial terms of the additional debt instruments that differ will change to match those of the original debt instruments (and the additional debt instruments will then become commercially fungible and Tax Fungible). In those situations, we believe that, if the Qualified Reopening Tests (or the other applicable requirements of the definition of issue) are satisfied as of the Reopening Date, the Commercial Fungibility Requirement need not be satisfied until commercial fungibility has been achieved.

Two examples that arise regularly in the capital markets, as described in more detail below, are (1) unregistered bonds that are expected to be exchanged shortly after issuance for registered bonds with substantially identical terms and (2) debt instruments issued into escrow pending the satisfaction of a condition that is reasonably expected to occur (such as the consummation of a pending acquisition):

1. *Unregistered Bonds*

Bonds are regularly issued to qualified institutional investors without the filing of a registration statement with the Securities and Exchange Commission (the "SEC") in reliance on an exemption from registration pursuant to Rule 144A under the Securities Act of 1933, as amended (a "Rule 144A Offering"). The exemption from registration allows issuers to access the capital markets more quickly.

Investors in a Rule 144A Offering often expect and require the issuer, within a specified time period after the Rule 144A Offering, to file a registration statement with the SEC and offer

to exchange the unregistered bonds for registered bonds with substantially identical terms (an "A/B exchange"). If a required A/B exchange is not consummated in a timely manner, the issuer generally would be required to pay additional interest to the holders (typically 25 basis points per annum with the possibility of additional increases) until the registration default is cured ("default interest"). The possibility of any default interest being paid is quite low, and such contingency generally is ignored for purposes of determining whether the additional debt instruments are contingent payment debt instruments within the meaning of Treas. Reg. § 1.1275-4 ("CPDIs") and in determining the payment schedule of the additional debt instruments (for purposes of computing the yield to maturity and OID accrual schedule).[61] But the default interest feature nevertheless prevents the unregistered bonds from being commercially fungible with the original registered bonds.[62]

The exchange of unregistered bonds for registered bonds with substantially identical terms generally is viewed as a modification of the unregistered bonds that is not "significant" (within the meaning of Treas. Reg.§ 1.1001-3) and therefore does not result in a Deemed Reissuance (*i.e.*, the registered bonds are treated, for U.S. federal income tax purposes, as a continuation of the unregistered bonds).

2. *Escrow Issuances*

An issuer with a need for cash in the near future (*e.g.*, to fund a pending acquisition) may borrow the funds in advance to take advantage of attractive financing terms. In such a case, the issuer is often required to place the borrowed funds in escrow and, if the need for the funds does not materialize by an agreed outside date, to redeem the debt instruments (the "escrowed debt instruments") at par. At the time the escrowed debt instruments are issued, the issuer reasonably expects the escrow condition to occur, as evidenced by the significant negative arbitrage that the issuer is willing to bear during the escrow period.

The payment terms of the additional debt instruments (*i.e.*, the interest rate, interest payment dates, maturity date, principal amortization schedule (if any) and applicable currency of the escrowed debt instruments), other than the contingent early mandatory redemption if the escrow condition ultimately is not satisfied (the "contingent early redemption"),[63] will typically match

---

[61] See Treas. Reg. §§ 1.1275-4(a)(2)(iii) and -4(a)(5) (for purposes of the CPDI rules, certain contingencies that are considered remote, incidental or significantly more likely than not to not occur may be ignored) and Treas. Reg. § 1.1272-1(c)(2) (which allows an issuer to ignore certain contingencies, for purposes of determining the yield to maturity and OID accrual schedule, if the expected payment schedule is significantly more likely than not to occur).

[62] In some cases, another difference in payment terms that prevents the unregistered bonds from being commercially fungible with the registered bonds is the absence of pre-issuance accrued interest. If an issuer does not expect to consummate the A/B exchange until after the next interest payment date on the registered bonds, the unregistered bonds may be issued without pre-issuance accrued interest.

[63] The contingent early redemption, like the contingency of paying default interest on an unregistered bond (as discussed above), is generally ignored for purposes of the CPDI rules and in determining the yield to maturity and OID accrual schedule of the escrowed debt instruments. See note 61 above.

the corresponding terms of the original debt instruments with which the escrowed debt instruments are intended to become commercially fungible, but the collateral for the escrowed debt instruments during the escrow period would be limited to the escrowed funds (plus additional funds contributed by the issuer to service the interest payable during the escrow period). Certain covenants may also differ during the escrow period. Once the escrow condition is satisfied (*e.g.*, the pending acquisition closes) and the escrowed funds are released to the issuer, the commercial terms of the escrowed debt instruments that differ (including those relating to the contingent early redemption, guarantees and collateral, and certain covenants) will change automatically to match the corresponding commercial terms of the original debt instruments.

The commercial changes to the escrowed debt instruments that occur when the escrow condition is satisfied generally do not result in a "modification" of the escrowed debt instrument (within the meaning of Treas. Reg. § 1.1001-3), and therefore do not result in a Deemed Reissuance of such debt instruments, because such changes occur pursuant to the original terms of such debt instruments.[64]

An issuer may be precluded by covenants in the issuer's existing debt instruments from issuing the escrowed debt instruments directly (*e.g.*, because the issuer will not have enough assets to satisfy its debt covenants until after the pending acquisition (to which the escrow relates) has closed). In such a case, an issuer may use a special purpose vehicle (an "Escrow Issuer") to issue the escrowed debt instruments. Once the escrow condition is satisfied and the escrowed funds are released to the "real" issuer, the Escrow Issuer will typically merge or liquidate into the real issuer, the real issuer will assume the escrowed debt instruments and the commercial terms of the escrowed debt instruments that differ from those of the applicable original debt instruments will change automatically to match the corresponding commercial terms of such original debt instruments. These changes to the escrowed debt instruments (including the change in obligor) generally are viewed as not resulting in a Deemed Reissuance of the escrowed debt instruments.[65]

To address situations like the two described above, we recommend that, if (1) additional debt instruments with the same payment terms as the applicable original debt instruments (other than (A) one or more payment contingencies that are ignored for purposes of the CPDI rules and in determining the yield to maturity and OID accrual schedule under Treas. Reg. § 1.1272-1(c) or (B) the existence or absence of pre-issuance accrued interest) are issued, for a non-tax purpose, with other commercial terms that differ from the corresponding commercial terms of the original debt instruments, (2) at the time of issuance, it is reasonably expected that, within one year of issuance, the commercial terms of the additional debt instruments that differ from those of the original debt instruments will change to match the corresponding commercial terms of the original debt instruments, (3) the anticipated changes actually occur within the one year period and

---

[64] See Treas. Reg. § 1.1001-3(c)(1)(ii) (subject to certain exceptions, an alteration that occurs pursuant to the original terms of a debt instrument does not result in a modification).

[65] See Treas. Reg. §§ 1.1001-3(e)(4)(B) and (C) (a change in obligor does not result in a Deemed Reissuance if such change occurs pursuant to a transaction described in Section 381(a) or if the new obligor acquires substantially all of the assets of the original obligor, the transaction does not result in a change in payment expectations, and the transaction does not result in a significant alteration).

(4) such changes do not result in a Deemed Reissuance,[66] the new Commercial Fungibility Requirement need not be satisfied until such changes occur.

While, in concept, the foregoing recommendation (to allow delayed fungibility if certain conditions are satisfied) should apply for purposes of both the qualified reopening rules and the definition of issue, we think that the recommended change can be limited to the qualified reopening rules. As a practical matter, (1) an issuer rarely, if ever, would pursue a reopening involving delayed fungibility within 13 days of the issuance of the original debt instruments and (2) if an issuer unexpectedly did so, the reopening could still be treated as a qualified reopening (as long as the 110% Yield Test can be satisfied).

C. The Underwriter Rule, the 13 Day Rule and the Definitions of Issue Date Should Be Clarified Where Underwriters Acquire Debt Instruments Pursuant to a Financing Commitment and Are Unable to Achieve a Successful Syndication

The intended operation of Treas. Reg. § 1.1273-2(e) (the Underwriter Rule"),[67] the 13 Day Rule and the definitions of "issue date"[68] is uncertain in situations in which arrangers or underwriters (collectively, "underwriters") acquire debt instruments pursuant to a financing commitment and are unable, on or prior to the closing date of the financing, to syndicate all of the debt instruments to third party purchasers not acting in the capacity of underwriters (*i.e.*, to achieve a "successful syndication").

The foregoing situation occurs regularly in market practice. Issuers and financial sponsors frequently ask underwriters to provide financing commitments before the underwriters have an opportunity to market the debt instruments (*e.g.*, in connection with a bid by the issuer or financial sponsor to acquire a target company). If the market moves unfavorably between the commitment date and the closing date of the financing, the underwriters may be required (or may decide) to hold some or all of the debt instruments for a period of time after closing. If the underwriters sell the debt instruments gradually over time, a question arises as to whether all of the debt instruments are Tax Fungible (even though all of the debt instruments are commercially fungible and were funded and issued (for commercial purposes) on the same date). This concern arises in part from the fact that the Underwriter Rule ignores sales to underwriters for purposes of determining both the issue price and the issue date. The uncertainty on this point impacts reopenings but also stand-alone debt offerings not involving the qualified reopening rules.

Consider the following example. Several months in advance of a pending acquisition, a group of underwriters commits to an issuer to fund a $1 billion tranche of term loans (with a six

---

66 If the change in terms resulted in a Deemed Reissuance, the date on which such change in terms occurred would become the Reopening Date of the deemed new additional debt instruments and the Qualified Reopening Tests would have to be reapplied as of such date.

67 The Underwriter Rule provides that "[f]or purposes of determining the issue price and issue date of a debt instrument under [Section 1273], sales to bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers are ignored."

68 See Treas. Reg. §§ 1.1273-2(a)(2), (b)(2), (c)(2) and (d)(2).

year term) for an interest rate not to exceed LIBOR plus 500 basis points. The market subsequently declines and the underwriters are unable to syndicate any of the loans at par in advance of closing. The underwriters fund the entire $1 billion of term loans at a price of 98 (par less a 2% underwriting discount) and hold the loans on their balance sheets, waiting for the market to improve. The market begins to improve and, five days after closing, one of the underwriters sells its entire $100 million position to a third party buyer (not acting in the capacity of an underwriter) for a price of 99. The market then declines again and none of the other underwriters sells its position until 20 days after closing. Over the following five days (*i.e.*, between 20 and 25 days after closing), each of the remaining underwriters sells its entire position at varying prices that are substantially below 99 (and below the price at which any of such sales could satisfy the 110% Yield Test in relation to the sale by the first underwriter).

Is the entire $1 billion tranche of term loans Tax Fungible? The prevailing view (and we believe the correct view from a policy perspective) is yes. The loans were all funded and issued (for commercial purposes) at the same time, and should be treated as having one uniform issue price and issue date for U.S. federal income tax purposes. But some practitioners are concerned that the Underwriter Rule treats a loan sold to an underwriter as not outstanding for U.S. federal income tax purposes until such loan is resold to persons not acting in the capacity of underwriters. As noted above, the Underwriter Rule provides that sales to underwriters should be ignored for purposes of determining both the issue price and the issue date of a debt instrument. Such an interpretation, if correct, would treat different portions of the tranche described in the example as issued on different dates that extend beyond a 13 day period, at various prices that would not allow the loans sold later to be a qualified reopening of the loans sold earlier.

The wording of the 13 Day Rule adds to the foregoing uncertainty. The 13 Day Rule provides that, for an additional debt instrument to be part of the same issue as an original debt instrument, the additional debt instrument must be issued "within the same 13 day period as the first sale of the original debt instruments to persons not acting in the capacity of underwriters."

The loans in the foregoing example were funded and issued for commercial purposes on the closing date (and began accruing interest from such date) and, we believe, should be treated, for U.S. federal income tax purposes, as issued on such date (as opposed to the later date on which a substantial portion of such loans are sold to persons not acting in the capacity of underwriters). The sales to underwriters should be ignored for purposes of determining the issue price but not for purposes of determining the issue date. In the foregoing example, assuming that the first sale of $100 million of the loans represented a "substantial amount" of the issue (which we believe to be the case[69]), the issue price of all of the loans should be 99 (the first price at which a substantial amount of the loans was sold to persons not acting in the capacity of underwriters),

---

[69] While there is no definition of "substantial amount" for purposes of determining an issue price under Section 1273, analogous provisions in the tax-exempt bond rules provide that (1) the issue price of tax-exempt bonds issued for money is the first price at which a "substantial amount" of the bonds is sold to the public and (2) ten percent is a substantial amount. See Treas. Reg. §§ 1.148-1(f)(2)(i) and (f)(4)(ii).

the issue date of all of the loans should be the closing date and the entire tranche should be Tax Fungible.[70]

We recommend that the Underwriter Rule and the 13 Day Rule be clarified accordingly. We also recommend that the four definitions of issue date be replaced with a uniform definition under which, subject to the anti-abuse rule described below, the issue date would be the date on which a debt instrument is treated as issued under general U.S. federal income tax principles. In most cases, that will be the date on which a debt instrument has been funded and issued for commercial purposes, even if the debt instrument continues to be held by an underwriter on such date. If, however, the acquisition of debt instruments by an underwriter is structured with a principal purpose of circumventing the qualified reopening rules, the issue date of such debt instruments would instead be the date on which the underwriter resells a substantial portion of such debt instruments to persons not acting in the capacity of underwriters. This anti-abuse rule could apply, for example, where an underwriter purchases additional debt instruments shortly before the six month anniversary of the issuance of the original debt instruments (for a principal purpose of allowing the additional debt instruments to qualify for the 110% Yield Test), if the underwriter's acquisition of the additional debt instruments is structured in an atypical manner that insulates the underwriter from risk of loss to a material extent (*e.g.*, by providing the underwriter with a put right or other price protection or by reimbursing the underwriter for the purchase of similar protection from a third party). But the anti-abuse rule should not apply if the underwriter purchases the additional debt instruments on customary terms and bears the full risk of loss with respect to such debt instruments.

D. The 13 Day Rule Should Be Relaxed For Overallotment ("Greenshoe") Options

We recommend that the 13 Day Rule be relaxed for additional debt instruments issued pursuant to overallotment ("greenshoe") options.

Greenshoe options are often provided to underwriters in connection with the issuance of convertible debt instruments. To assist underwriters with their market stabilization activities, a greenshoe option allows the underwriter to purchase from the issuer, for a brief time period after the issuance of the original debt instruments, a limited amount of additional debt instruments with the same commercial terms as the original debt instruments (typically an amount of additional debt instruments not in excess of 10 percent of the original debt instruments). The exercise price of a greenshoe option generally is the same as the price paid by the underwriter to acquire the original debt instruments (and typically reflects an underwriter discount). A greenshoe

[70] A related question, which this Report does not address, is how to determine the issue price of an issue of debt instruments that is sold to underwriters in a committed deal where, for a meaningful period of time after closing, no more than an insignificant portion of the debt instruments is resold to persons not acting in the capacity of underwriters. The Underwriter Rule does not work well in this situation (and probably was not written with this situation in mind). The price paid by the underwriters does not reflect the value of the debt instruments at the time the debt instruments are issued (due to an unanticipated market decline after the underwriters provided their financing commitment) but the debt instruments are funded and issued (for commercial purposes) on the closing date and the underwriters are effectively acting as principals and bearing the risk of ownership. There is significant uncertainty in the marketplace on this issue (and a range of views).

option typically is exercisable until 30 days after issuance of the original debt instruments. The 30 day period is not motivated by tax considerations.

Under the 13 Day Rule, additional debt instruments issued pursuant to a greenshoe option more than 12 days after issuance of the original debt instruments will not be part of the same issue as the original debt instruments. While the additional debt instruments may still be Tax Fungible under the qualified reopening rules, the potential lack of Tax Fungibility can be disruptive to the underwriters' market stabilization activities. Moreover, because convertible debt instruments typically have lower yields than comparable non-convertible debt instruments, the risk of failing the 110% Yield Test may be significant.[71]

We recommend that, in the case of additional debt instruments issued pursuant to greenshoe options, the 13 Day Rule be relaxed to allow for a period of 30 days plus a reasonable and customary settlement period.

V. Technical Improvements to the Rules Governing Tax Fungibility

This Part V recommends technical improvements to the rules governing Tax Fungibility.

A. How Should the Qualified Reopening Tests Apply to Additional Debt Instruments Issued Within the Same 13 Day Period?

There is uncertainty about how to apply the Qualified Reopening Tests to additional debt instruments that are issued within the same 13 day period and that, without regard to the qualified reopening rules, would satisfy the 13 Day Rule and be part of the same issue.

Consider the following example. A tranche of six year notes was issued at par seven months ago (the "original notes"). All of the interest payable with respect to the original notes is qualified stated interest, and no amortization of principal is required or permitted.

The issuer issues additional notes (the "Initial Additional Notes") with identical terms to the original notes at a price (98.76 or higher) that satisfies the De Minimis Test. As part of a series of related transactions, the issuer then issues more additional notes (the "Subsequent Additional Notes"), within the same 13 day period as the Initial Additional Notes, at a price of 98.75 or less. The Subsequent Additional Notes would, absent the qualified reopening rules, be treated as part of the same issue as the Initial Additional Notes (pursuant to the 13 Day Rule).

The question is whether the Subsequent Additional Notes may be treated as part of the qualified reopening of the original notes even though the Subsequent Additional Notes, standing alone, would have failed the De Minimis OID Test. Should the two offerings of additional notes

---

[71] For example, assume that an underwriter has a 30 day greenshoe option (at an exercise price of 97, reflecting a three percent underwriter discount). The original debt instruments, which were sold to investors at par, are 10 year convertible bonds that pay qualified stated interest in cash, semiannually, at an interest rate of two and one-half percent per annum. If the underwriter exercises the greenshoe option after the initial 13 day period and resells the additional bonds at a price below 97.81, the 110% Yield Test will not be satisfied.

first be treated as part of one issue (pursuant to the 13 Day Rule) and then be tested collectively under the qualified reopening rules, or should each offering of additional notes be tested separately for qualified reopening status?

The answer appears to be the former. Under Treas. Reg. §1.1275-2(k)(2)(ii), "additional debt instruments" for purposes of the qualified reopening rules mean debt instruments that, without the application of the qualified reopening rules, (A) are part of a single issue of debt instruments, (B) are not part of the same issue as the original debt instruments, and (C) satisfy the Identical Terms Requirement.

Although not entirely clear, the better reading of the foregoing rule would appear to be to aggregate the two offerings of additional debt instruments to create one new "issue" (with an issue price of 98.76 or higher) and then apply the qualified reopening rules to the new issue in its entirety. As a policy matter, we believe that this interpretation sensibly provides an issuer (and other market participants) with certainty, at the inception of the reopening process, that all additional debt instruments issued within the same 13 day period (as part of a common plan or a series of related transactions) can be part of the qualified reopening (regardless of market fluctuations within such 13 day period).

To eliminate any uncertainty, we recommend that the following sentence be added to the end of Treas. Reg. § 1.1275-2(k)(2)(ii): The qualified reopening tests in paragraphs (k)(3)(ii), (k)(3)(iii) and (k)(3)(iv) will apply uniformly to all of the additional debt instruments, as if such debt instruments were all issued on the date on which the first such debt instrument is issued (for a price equal to the actual issue price of such first debt instrument).

B. Is the 13 Day Rule Really a 12 Day Rule?

The 13 Day Rule (Treas. Reg. §1.1275-1(f)(1)(iii)) provides that an additional debt instrument may be part of the same issue as the original debt instrument only if the additional debt instrument is issued within a period of thirteen days beginning with the date on which the original debt instrument is issued to a person not acting in the capacity of an underwriter.

As currently drafted, the 13 Day Rule is technically a 12 day rule because the 13 day period includes both the date on which the original debt instrument is issued and the date on which the additional debt instrument is issued. For example, if the original debt instrument is issued on the first day of the month, the additional debt instrument must be issued no later than the 13th day of the month (*i.e.*, no more than 12 days later). This technical point has become a trap for the unwary. We recommend that either the language be amended to allow for a true 13 day period or, alternatively, to clarify that the rule is actually a 12 day rule.

C. The De Minimis OID Test in the Qualified Reopening Rules Should Be Clarified

We recommend a minor technical clarification to the De Minimis OID Test in the qualified reopening rules. Under Treas. Reg. § 1.1275-2(k)(3)(iii)(B), additional debt instruments will satisfy the De Minimis OID Test (for qualified reopening status) if "[t]he additional debt instruments are issued with no more than a de minimis amount of OID (determined without the application of this paragraph (k))" (emphasis added). In contrast, Treas. Reg. § 1.1273-1(d)(1) (the

rule that generally applies for determining whether a debt instrument has de minimis OID) provides that the amount of OID on a debt instrument shall be treated as zero (-0-) if the amount of OID "is less than the de minimis amount" (emphasis added). Treas. Reg. § 1.1273-1(d)(2) provides that, in general, the "de minimis amount" is "an amount equal to 0.0025 multiplied by the product of the stated redemption price at maturity and the number of complete years to maturity from the issue date."

We assume that the difference highlighted above between the language in Treas. Reg. § 1.1275-2(k)(3)(iii)(B) and the language in Treas. Reg. § 1.1273-1(d)(1) was unintentional and that the generally applicable test for measuring de minimis OID should also apply to the qualified reopening rules. Accordingly, we recommend that Treas. Reg. § 1.1275-2(k)(3)(iii)(B) be amended to read as follows: "(B) The additional debt instruments are issued with less than a de minimis amount of OID (determined without the application of this paragraph (k))."

D. The Qualified Reopening Rules Should Apply Based on the Tax Treatment of the Applicable Debt Instruments to the Holders

As discussed throughout this Report, the qualified reopening rules focus on limiting the conversion of Holder OID into market discount. If, for U.S. federal income tax purposes, an applicable debt instrument is treated as having different terms with respect to the holders than with respect to the issuer, the qualified reopening rules should apply based on the U.S. federal income tax treatment to the holders. Thus, for example, the application of the qualified reopening rules to an applicable debt instrument should not be impacted by an election by the issuer to integrate such debt instrument with a hedge pursuant to Treas. Reg. § 1.1275-6. We recommend that this point be made explicit in the qualified reopening rules.

E. Additional Debt Instruments Issued in a Qualified Reopening Generally Should Be Deemed to Have the Same Term (Duration) as the Original Debt Instruments in Determining Whether the Additional Debt Instruments Will Be Considered Securities for Purposes of the Rules Governing Spinoffs and Reorganizations

Even if additional debt instruments satisfy the Qualified Reopening Tests, such debt instruments may not be Tax Fungible with the original debt instruments (and may therefore be ineligible to have the same CUSIP number) if the original debt instruments are considered "securities" for purposes of the rules governing spinoffs and reorganizations (*i.e.*, Sections 354 through 368) but the additional debt instruments are not (due to the shorter term (duration) of the additional debt instruments). We believe that additional debt instruments that satisfy the Qualified Reopening Tests generally should be treated as securities for such purposes if the original debt instruments are treated as securities.

Treasury provided similar relief to address the issue of grandfathering for purposes of Sections 1471 through 1474 ("FATCA withholding"). Debt instruments issued on or prior to June 30, 2014 were permanently exempt from FATCA withholding unless such debt instruments were significantly modified after June 30, 2014. Debt instruments issued after June 30, 2014 generally were not grandfathered with respect to FATCA withholding. This issue could have caused additional debt instruments issued after June 30, 2014 in a qualified reopening not to be Tax Fungible with original debt instruments issued on or prior to June 30, 2014.

Treasury responded to the FATCA grandfathering concern by issuing Treas. Reg. § 1.1471-2(b)(2)(iii), which deems a debt instrument to be grandfathered with respect to FATCA withholding if the issue date of such debt instrument is on or prior to June 30, 2014. This solved the Tax Fungibility problem because additional debt instruments issued in a qualified reopening are deemed to have the same issue date as the original debt instruments.[72]

To provide a similar fix regarding the issue of whether additional debt instruments qualify as securities, we recommend that the following language be added to the end of Treas. Reg. § 1.1275-2(k)(1): In addition, subject to the next sentence, for purposes of determining whether additional debt instruments are considered securities for purposes of sections 354 through 368 (the spinoff and reorganization rules), additional debt instruments shall be deemed to have been issued on the issue date of the original debt instruments. The preceding sentence shall not apply if the additional debt instruments were structured as a qualified reopening for a principal purpose of circumventing the requirement that the additional debt instruments qualify as securities for purposes of the spinoff and reorganization rules.

F. The Qualified Reopening Rules Should Not Be Used to Circumvent the AHYDO Rules

If additional debt instruments would, absent the qualified reopening rules, be treated as applicable high yield discount obligations within the meaning of Section 163(i)(1) ("AHYDOs"), a reopening of such additional debt instruments should not be a qualified reopening unless the original debt instruments also are AHYDOs.

To clarify this point, we recommend that the following sentence be added at the end of Treas. Reg. § 1.1275-2(k)(3)(vi): In addition, this paragraph (k)(3) does not apply to additional debt instruments that, without the application of this paragraph (k), would be applicable high yield discount obligations within the meaning of section 163(i)(1) (AHYDOs), unless the applicable original debt instruments also are AHYDOs.

G. Debt Instruments Issued as Part of the Same Issue under the 13 Day Rule Generally Cannot Also Be Part of an Issue Including Debt Instruments Issued after the 13 Day Period

If a debt instrument (a "subsequently issued debt instrument") is considered part of the same issue as other debt instruments issued earlier in the same 13 day period, the subsequently issued debt instrument cannot restart a new 13 day period. This rule is needed to prevent issuers from effectively extending the 13 day period.

Assume that three debt instruments that are commercially fungible are issued (as part of a common plan) on day one, day 10 and day 16, respectively. The first two debt instruments should be considered part of the same issue. But the third debt instrument, even though it is issued within the same 13 day period as the second debt instrument, should not be considered part of the same issue as the second debt instrument and should be considered Tax Fungible with the

[72] See Treas. Reg. § 1.1275-2(k)(1).

first two debt instruments only if the third debt instrument can be treated as a qualified reopening.

Accordingly, we recommend that the following sentence be added at the end of revised Treas. Reg. § 1.1275-1(f)(1): If a debt instrument (a subsequently issued debt instrument) is considered part of the same issue as another debt instrument issued earlier in the same 13 day period, the subsequently issued debt instrument cannot also be part of an issue that includes debt instruments issued after the 13 day period (unless the later-issued debt instruments are treated as a qualified reopening of the debt instruments issued within the 13 day period).[73]

H. Additional Debt Instruments Should Include Existing Debt Instruments That Are Deemed Reissued for U.S. Federal Income Tax Purposes

It should be clarified that additional debt instruments can include existing debt instruments that are deemed reissued for U.S. federal income tax purposes (including pursuant to Treas. Reg. §§ 1.108-2, 1.1001-3 or 1.1502-13(g)).

To clarify this point, we recommend that the first sentence of Treas. Reg. § 1.1275-2(k)(2)(ii) be amended to read as follows (emphasis added):

(ii) *Additional debt instruments*. – Additional debt instruments are debt instruments (including existing debt instruments that are deemed reissued for U.S. federal income tax purposes (*e.g.*, pursuant to §§ 1.108-2, 1.1001-3 or 1.1502-13(g))) that, without the application of this paragraph (k) ….

I. For Purposes of Applying the Small Issuance Exception to Additional Debt Instruments, the Original Debt Instruments Should Be Treated as Part of the Same Issue as the Additional Debt Instruments

We recommend that the small issuance exception in the Public Trading Regulations (described below) be clarified to provide that, for purposes of applying such exception to additional debt instruments, the applicable original debt instruments will be treated as part of the same issue as the additional debt instruments.

Treas. Reg. § 1.1273-2(f)(6) (the "small issuance exception") provides that a debt instrument will not be considered publicly traded for purposes of the Public Trading Regulations if, at the time such determination is made, the outstanding stated principal amount of the issue that includes such debt instrument does not exceed $100 million (or, for a debt instrument denominated in a foreign currency, an equivalent amount of such currency).

---

[73] There is a similar provision in the current qualified reopening rules. See Treas. Reg. § 1.1275-2(k)(2)(i) ("For purposes of determining whether a particular reopening is a qualified reopening, debt instruments issued in prior qualified reopenings are treated as original debt instruments and debt instruments issued in the particular reopening are not so treated.").

Consider the following example. One billion dollars of principal amount of bonds issued for cash at par on January 1, 2019 (the "2019 bonds") are now trading at a price of 80. The issuer proposes to issue $75 million principal amount of additional 2019 bonds to acquire Blackacre. Can the reopening be treated as a qualified reopening based on Actual Issue Price Testing?[74]

The answer should be no. Even though the principal amount of the additional 2019 bonds does not exceed $100 million, $1 billion of original 2019 bonds, which are commercially fungible with the additional 2019 bonds, are publicly traded. Accordingly, (1) the small issuance exception should not apply to the additional 2019 bonds, (2) the additional 2019 bonds should be treated as publicly traded, (3) the Actual Issue Price of the additional 2019 bonds should be 80 and (4) the additional 2019 bonds should not be treated as a qualified reopening of the original 2019 bonds. But there is some uncertainty as to whether the current wording of the small issuance exception allows the issuer to treat the additional 2019 bonds as a separate issue for this purpose.

We recommend that the language of the small issuance exception be amended to read as follows (emphasis added):

> Except as provided in the next sentence, [n]otwithstanding any other provision in paragraph (f) of this section, …. For purposes of applying the preceding sentence to additional debt instruments (as defined in § 1.1275-2(k)(2)(ii)), the applicable original debt instruments (as defined in § 1.1275-2(k)(2)(i)) shall be treated as part of the same issue as such additional debt instruments.

J. If Additional Debt Instruments Are Issued in a Qualified Reopening, What Should the Issue Price of Such Additional Debt Instruments Be for Other Purposes of the Code?

Treas. Reg. § 1.1275-2(k)(1) provides that additional debt instruments issued in a qualified reopening will be deemed to have the same issue price as the original debt instruments. But should that be true for all purposes of the Code?

Assume that bonds were issued for cash in 2017 at an issue price of 97. The bonds (the "2017 bonds") currently have an adjusted issue price of 97.5 and are trading at par. The issuer proposes to issue $100 principal amount of additional 2017 bonds to acquire Whiteacre from Seller. The additional 2017 bonds will be treated as a qualified reopening of the original 2017 bonds (pursuant to both the 100% Yield Test and the De Minimis OID Test) and will therefore be deemed to have an issue price of 97.5 (*i.e.*, the adjusted issue price of the original 2017 bonds). Should Seller's amount realized with respect to the sale of Whiteacre be $97.50 (*i.e.*, the deemed issue price of the additional 2017 bonds pursuant to the qualified reopening rules) or $100 (*i.e.*, the Actual Issue Price)?

A similar question would arise if, instead of issuing the additional 2017 bonds to acquire Whiteacre, the issuer issued the $100 principal amount of additional 2017 bonds in exchange for

---

[74] Announcement Date Value Testing will not help the issuer in this case because the Announcement Date Value would be $80.

another debt instrument of the issuer with an adjusted issue price of par (the "other debt instrument"). For purposes of determining whether the issuer has any cancellation of indebtedness income (for purposes of Sections 61 and 108) with respect to the other debt instrument, should the issue price of the additional 2017 bonds be $97.50 or $100?

While a recommendation on this issue is beyond the scope of this Report, we note that it may be appropriate, for other purposes of the Code, to determine the issue price of additional debt instruments issued in a qualified reopening without regard to the qualified reopening rules (particularly where the term "issue price" is being used as a surrogate for value). Such an approach would be appropriate only if, as in the two scenarios described above, the result would not preclude Tax Fungibility of the additional debt instruments (and thereby frustrate the purpose of the qualified reopening rules).

VI. A Deemed OID Election Would Expand the Opportunity for Tax Fungibility Without Converting Any Additional Holder OID into Market Discount

This Part VI recommends a new issuer election that would expand the opportunity for Tax Fungibility without converting additional Holder OID into market discount. As explained below, the new election (a "Deemed OID Election") would allow an issuer, subject to certain conditions, to deem the original debt instruments to have been reissued, on the Reopening Date, for a deemed reissuance price equal to the Actual Issue Price of the additional debt instruments (or, if the additional debt instruments are treated as a qualified reopening of other original debt instruments, for a deemed reissuance price equal to the adjusted issue price of such other original debt instruments as of the Reopening Date[75]).

A. A Deemed OID Election Would Be Beneficial in the Current Market Environment, in which Issuers Frequently Seek to Do Tax Fungible Reopenings More Than Six Months after Issuance of the Original Debt Instruments

A Deemed OID Election would be beneficial in the current market environment, in which issuers frequently seek to do Tax Fungible reopenings more than six months after issuance of the original debt instruments. One trend that illustrates this growing phenomenon is the proliferation of delayed draw term loan facilities ("DDTL Facilities") in term loan credit agreements. A DDTL Facility requires lenders under a term loan credit facility to commit, at closing, to fund additional term loans with the same commercial terms as the original term loans ("DDTLs"), at the same price at which the original term loans were sold. Issuers frequently need the flexibility to request multiple DDTLs (often in small increments) for a period of up to two years. To commit to a DDTL Facility, lenders need assurance that the DDTLs will be fungible with the original term loans. Even though the original term loans and the DDTLs are sold at the same price, if the term of the DDTL Facility exceeds six months, fungibility will be a concern unless all of the

---

[75] This parenthetical language is intended primarily to address Tax Fungibility issues that arise in connection with certain "debt roll-ups," as discussed below in Section B of this Part VI.

DDTLs are issued with less than de minimis OID (because the 110% Yield Test is unavailable after six months and the 100% Yield Test cannot be satisfied[76]).

Treasury could address this issue by extending the 110% Yield Test to reopenings occurring more than six months after issuance of the original debt instruments. When faced with this question in 2001, Treasury concluded that, for reopenings occurring more than six months after the issuance of the original debt instruments, the De Minimis OID Test should be the only available Qualified Reopening Test.[77] But, as noted above, the need for Tax Fungible reopenings outside of the six month window is far greater than it was in 2001. Moreover, many holders would not be impacted by a change in the amount of Holder OID, including holders that are mark-to-market taxpayers, tax-exempt entities, non-U.S. taxpayers eligible for portfolio interest treatment or taxpayers that have elected, pursuant to Treas. Reg. § 1.1272-3, to treat all of the yield with respect to their debt instruments as OID. However, some holders would derive a tax benefit from a new rule that permitted conversion of Holder OID into market discount outside of the six month window. Treasury should weigh these factors in considering whether the line it drew in 2001 is still the appropriate line today.

Alternatively, Deemed OID Elections would provide greater flexibility to do Tax Fungible reopenings after the six month window, but without any additional conversion of Holder OID into market discount.[78]

B. Deemed OID Elections Could Help Some Issuers That Are Pursuing Debt Roll-Ups But Are Unable to Satisfy the Strict Requirements of Rev. Proc. 2001-21

Deemed OID Elections could help some issuers that would like to roll up multiple tranches of debt instruments into one commercially fungible (and Tax Fungible) tranche (*i.e.*, to

---

[76] If there is more than de minimis OID, the 100% Yield Test cannot be satisfied with respect to a DDTL unless the DDTL is sold at a price higher than the issue price of the original term loans, to account for the OID that has accrued on the original term loans since their issuance (*i.e.*, at a price equal to the adjusted issue price of the original term loans as of the Reopening Date).

[77] In the preamble to the 2001 Final Regulations, Treasury noted a suggestion from some commentators that a rule like the 110% Yield Test be made available throughout the term of the original debt instruments, but declined to follow that suggestion: "The final regulations do not adopt this suggestion. The IRS and the Treasury Department believe that the changes to the de minimis test described above provide the appropriate relief for debt instruments reopened after the six month period." Preamble to Treas. Reg. § 1.1275-2(k) (2001), supra note 5, at 907. A third Qualified Reopening Test (the 100% Yield Test) was subsequently added to the qualified reopening rules (as part of the 2012 Final Regulations), but the 100% Yield Test is helpful only in some cases in which the original debt instruments were issued with more than de minimis OID.

[78] Deemed OID Elections would also provide some flexibility to do additional Tax Fungible reopenings within the six month window (for some additional debt instruments that cannot satisfy the 110% Yield Test), without any conversion of Holder OID into market discount.

do a "debt roll-up") but are unable to satisfy the strict requirements of IRS Revenue Procedure 2001-21 ("Rev. Proc. 2001-21"),[79] as discussed below.

In Rev. Proc. 2001-21, the IRS tried to assist issuers facing Tax Fungibility concerns in effecting a debt roll-up. Tax Fungibility would not pose a problem if each exchange of an old tranche of debt instruments (an "old tranche") for the new tranche of debt instruments (the "new debt instruments") resulted in a Deemed Reissuance (because, in such a case, all of the new debt instruments would be deemed issued at the same time and would have the same issue price). But if any exchange of an old tranche did not result in a Deemed Reissuance, the new debt instruments issued in exchange for such old tranche (an "unmodified old tranche") would be treated, for U.S. federal income tax purposes, as a continuation of the unmodified old tranche. Even if an unmodified old tranche had no more than de minimis OID prior to the exchange, if the stated principal amount of the new debt instruments received in exchange for the unmodified old tranche (the "unmodified new debt instruments") exceeded the stated principal amount of the unmodified old tranche, the unmodified new debt instruments would be deemed to have OID equal to such excess stated principal amount ("exchange related OID") and therefore would not be Tax Fungible with the remainder of the new debt instruments.

Rev. Proc. 2001-21 allows some issuers pursuing a debt roll-up to make a joint election with holders (a "substitution election") to treat any exchange related OID as market discount (instead of as OID). But, due to concerns about converting too much Holder OID into market discount, the IRS imposed strict conditions that limit the ability to make substitution elections. One such condition is that an unmodified old tranche did not have more than de minimis OID prior to the exchange.[80]

In some cases, the qualified reopening rules may help an issuer that is unable to satisfy the conditions of Rev. Proc. 2001-21. Assume that an issuer would like to exchange 10 old tranches for one tranche of new debt instruments. The new debt instruments are expected to trade at par when issued. Nine of the ten tranche exchanges will result in a Deemed Reissuance, but one tranche exchange will not. The unmodified old tranche had more than de minimis OID prior to the exchange. While a substitution election will therefore be unavailable, the issuer should be able to effect the debt roll-up by treating the new debt instruments issued in exchange for the other nine old tranches as a qualified reopening (pursuant to either the 100% Yield Test or the De Minimis OID Test) of the unmodified new debt instruments (which, as noted above, are deemed to be a continuation (in modified form) of the unmodified old tranche).

But what if there were two or more unmodified old tranches with different amounts of OID? The qualified reopening rules, standing alone, could not solve the problem because the unmodified old tranches would not be Tax Fungible with each other. But Deemed OID Elections, in conjunction with the qualified reopening rules, might solve the problem. If the issuer could make Deemed OID Elections with respect to all of the unmodified new debt instruments other than those with the greatest amount of OID, all of the unmodified new debt instruments would

---

[79] Rev. Proc. 2001-21, 2001-1 C.B. 742.

[80] See Section 3.04 of Rev. Proc. 2001-21, supra note 79, at 743.

become Tax Fungible with each other. The issuer could then treat all of the new debt instruments issued in tranche exchanges that resulted in Deemed Reissuances as a qualified reopening of the unmodified new debt instruments. Deemed OID Elections could thereby facilitate a debt roll-up without any conversion of Holder OID into market discount.

C. What Effect Would a Deemed OID Election Have and When Would An Election Be Permitted?

Subject to the conditions described below, we recommend that, if needed to achieve Tax Fungibility between original debt instruments and additional debt instruments, an issuer be permitted to make a Deemed OID Election to treat the original debt instruments as reissued on the Reopening Date for a deemed reissuance price equal to the Actual Issue Price of the additional debt instruments (or, if the additional debt instruments are treated as a qualified reopening of other original debt instruments, for a deemed reissuance price equal to the adjusted issue price of such other original debt instruments as of the Reopening Date).[81]

A Deemed OID Election would apply for purposes of (1) determining Holder OID with respect to the original debt instruments from and after the Reopening Date and (2) applying the qualified reopening rules and the definition of issue to the applicable reopening and any subsequent reopenings of the original debt instruments. The original debt instruments would not be deemed reissued for purposes of determining whether the original debt instruments are CPDIs (*i.e.*, CPDI status would not have to be retested). The increased Holder OID resulting from a Deemed OID Election would apply to holders for all purposes of the Code, and would also apply to issuers and other parties to the extent such parties are required to act as withholding agents with respect to any OID of such holders (including pursuant to Sections 1441, 1442 or 1471

[81] Regarding Treasury's authority to permit Deemed OID Elections, Section 1275(d) authorizes Treasury to "prescribe regulations providing that where, by reason of varying rates of interest, put or call options, indefinite maturities, contingent payments, assumptions of debt instruments, or other circumstances, the tax treatment under this subpart [*i.e.*, sections 1271 through 1275] (or section 163(e)) does not carry out the purposes of this subpart (or section 163(e)), such treatment shall be modified to the extent appropriate to carry out the purposes of this subpart (or section 163(e))." Section 1278(c) authorizes Treasury to prescribe such regulations "as may be necessary to carry out the purposes of this subpart [*i.e.*, sections 1276 through 1278] …."

While the foregoing grant of authority could be read narrowly to permit only those regulations that are needed to clearly reflect income of issuers and holders, we believe that such grant of authority could also be read to allow Treasury to address a non-tax issue affecting the capital markets in a manner that does not frustrate the purpose of the OID or market discount rules (as Treasury did in adopting the current qualified reopening rules). In some cases, the current qualified reopening rules effectively function as a form of Deemed OID Election with respect to additional debt instruments. For example, assume that an issuer of original bonds would like to pursue a reopening. The original bonds were issued more than six months ago for 97 (*i.e.*, with more than de minimis OID) but have since traded up to par. If the issuer sells the additional bonds for par in a stand-alone offering (with a separate CUSIP number), the additional bonds will have no OID. Instead, by structuring the offering as a qualified reopening (under either the 100% Yield Test or the De Minimis OID Test), the issuer can effectively elect to cause the additional bonds to have the same level of Holder OID as the original bonds.

through 1474) or are subject to information reporting obligations with respect to any OID of such holders (including pursuant to Sections 1461 through 1464 or 6049). For all purposes of the market discount rules (*i.e.*, Sections 1276 through 1278), a Deemed OID Election shall cause a holder of an original debt instrument to be treated as having exchanged such debt instrument (in a non-recognition transaction in which no gain or loss will be recognized) for a deemed new original debt instrument with an issue price equal to the deemed reissuance price.[82]

Except as provided in the preceding paragraph, a Deemed OID Election will not have any U.S. federal income tax consequences. Thus, for example, the election would have no U.S. federal income tax consequences to the issuer[83] and will not result in a realization event, or the recognition of any immediate income, gain, loss or deduction, to any holder. Similarly, a Deemed OID Election would not result in a "modification" of the original debt instruments for purposes of Treas. Reg. § 1.1001-3, and would not be taken into account in determining whether the original debt instruments were issued with "significant original issue discount" within the meaning of Section 163(i)(2).

A Deemed OID Election could be made by an issuer only if the effect of such election would be to increase the amount of Holder OID with respect to the original debt instruments.

To prevent a Deemed OID Election from being made in situations in which there could be a significant negative impact on some holders (*e.g.*, with respect to distressed debt trading at a significant discount), a Deemed OID Election could be permitted only if the deemed reissuance price of the original debt instruments would be no less than a specified threshold. To address this point but still make a Deemed OID Election useful in the current capital markets, a possible threshold price could be 93-95% of the adjusted issue price of the original debt instruments as of the Reopening Date, determined without regard to the Deemed OID Election (and any prior Deemed OID Elections). An argument can be made that the tax law should not mandate a

---

[82] This will ensure that any accrued and unaccrued market discount in the original debt instruments will be preserved in the deemed new original debt instruments, and that the deemed Holder OID and any market discount in the deemed new original debt instruments will sync up properly (*i.e.*, in the same manner as if the original debt instruments were actually exchanged for new debt instruments with OID).

[83] Although probably unnecessary because a Deemed OID Election will not result in a deemed reissuance of the original debt instruments to the issuer, rules similar to Treas. Reg. § 1.163-7(e) could require the issuer to treat the difference between the deemed reissuance price of the original debt instruments and the original issue price of such instruments as a negative adjustment to the issuer's interest expense. Treas. Reg. § 1.163-7(e) currently mandates this result, with respect to additional debt instruments issued in qualified reopenings, in cases in which the deemed issue price of the additional debt instruments that results from qualified reopening treatment is less than the Actual Issue Price (*e.g.*, if the original debt instruments were issued with more than de minimis OID and the additional debt instruments were sold at par but treated as a qualified reopening pursuant to the 100% Yield Test). The additional debt instruments are deemed (as a result of qualified reopening treatment) to have been issued with more than de minimis OID (notwithstanding their Actual Issue Price), but the additional Holder OID created by the qualified reopening rules has no impact on the issuer's OID deduction.

threshold price and that, in each case, market forces should determine whether holders will require a threshold price. But a threshold price requirement would allow Deemed OID Elections to be helpful in a large majority of cases while limiting the potential for unintended consequences.[84] We therefore recommend that Treasury include a threshold price requirement.

While a Deemed OID Election may negatively impact some holders (by converting market discount, de minimis market discount or de minimis OID into OID), we believe that, in many situations, few holders, if any, would be impacted to a material extent by such election. As discussed above, many holders are indifferent to an increase in Holder OID. Moreover, an original holder of an original debt instrument, as well as any subsequent holder that purchased or purchases the original debt instruments at a price above the deemed reissuance price would be deemed to have "acquisition premium"[85] that would offset some or all of the deemed OID created by a Deemed OID Election.

Because the actual impact to holders of a Deemed OID Election will vary, we recommend that Deemed OID Elections be permitted only if the terms of the original debt instruments (as reflected in the applicable credit agreement, securities purchase agreement, indenture or other governing document) (a) expressly permit the issuer to make such elections and (b) provide that a holder, by purchasing an original debt instrument, is deemed to have agreed to report such holder's income in a manner consistent with any Deemed OID Elections. These requirements would protect any holders that may be sensitive to converting even modest levels of market discount (or market discount or OID that is de minimis) into OID, while providing issuers (and other market participants) with enhanced flexibility to do Tax Fungible reopenings (without any additional conversion of Holder OID into market discount).

Should an issuer be permitted to amend outstanding original debt instruments that do not allow Deemed OID Elections to permit such elections (subject to the requirements of the preceding paragraph)? Under applicable corporate and/or securities laws, it appears that such an amendment often could be approved by a bare majority of holders. This might lead to disputes and possible litigation if, as expected, the holders are not all similarly situated from a tax standpoint (*e.g.*, if 50.1% of the holders, who are indifferent to increased Holder OID, approve the amendment and the other 49.9% of holders, who are disinclined to allow increased Holder OID, vote against the amendment). Treasury might therefore decide to prohibit Deemed OID Elections unless such elections are authorized when the original debt instruments are initially issued for commercial purposes (so that each investor can decide independently whether it wishes to own a debt instrument that permits Deemed OID Elections). But, alternatively, Treasury might

---

[84] For example, assume that an issuer that is not pursuing a reopening has a tranche of outstanding bonds (the "existing bonds") that are trading at a steep discount to par (*e.g.*, at 80). An affiliate of the issuer purchases some of the existing bonds in open market purchases. Pursuant to Treas. Reg. § 1.108-2, the purchased existing bonds generally will be treated, for all U.S. federal income tax purposes, as having been retired and reissued at a price of 80. If Deemed OID Elections were permitted without a threshold price requirement, the issuer could make a Deemed OID Election with respect to the remainder of the existing bonds and cause all of the existing bonds to have $20 of Holder OID going forward.

[85] See Section 1272(a)(7) and Treas. Reg. § 1.1272-2.

conclude that the tax law should allow issuers and their advisors to assess the pros and cons of seeking an amendment to authorize Deemed OID Elections.[86]

Treasury could consider limiting the number of Deemed OID Elections (or the frequency of such elections) with respect to a particular original debt instrument. But we believe that such a limitation would be inappropriate because an issuer would be permitted to make a Deemed OID Election only if needed to achieve Tax Fungibility with respect to an additional debt instrument. There are many debt instruments currently in the market with respect to which issuers can unilaterally cause repeated deemed reissuances, and there is no indication that these instruments are in disfavor. For example, the issuer of a PIK Toggle Note (discussed above in Part III) can unilaterally cause a deemed reissuance of a PIK Toggle Note (and thereby reset the yield and OID accruals to holders) each time the issuer elects to pay PIK Interest.

D. How Would a Deemed OID Election Be Made and What Reporting and Notice Requirements Would the Issuer Have?

A Deemed OID Election could be made by filing an election form with the IRS within a specified time period after the applicable Reopening Date (*e.g.*, within 30 days thereafter). The issuer would have reporting requirements with respect to the deemed OID that parallel the reporting requirements with respect to any other OID under Treas. Reg. § 1.1275-3. If the original debt instrument is "publicly offered" (within the meaning of Treas. Reg. § 1.1275-1(h)), the issuer would be required to file a new (or revised) IRS Form 8281.[87] If the original debt instrument is not "publicly offered" and is issued in physical form, the issuer would be required to comply with the legending requirements of Treas. Reg. § 1.1275-3(b).[88]

To inform holders that a Deemed OID Election has been made, the issuer could be required, within a specified time period after the applicable Reopening Date, to provide written notice of such election to all holders of record as of the Reopening Date. The issuer could also be required, within a specified time period after the Reopening Date, to make information regarding the Deemed OID Election (including the Reopening Date, the deemed reissuance price and, if Treasury deemed appropriate, a deemed OID accrual schedule) available to all holders in a commercially reasonable manner (*e.g.*, by publishing such information on the issuer's website).[89]

---

[86] We recommend that, if Treasury decides to take this approach, such an amendment not be considered a "modification" of the original debt instruments for purposes of Treas. Reg. § 1.1001-3.

A possible third alternative would be to allow amendments that permit Deemed OID Elections, but only if the original debt instruments were initially issued for commercial purposes after the date on which rules permitting Deemed OID Elections are promulgated.

[87] See Treas. Reg. § 1.1275-3(c).

[88] The issuer would be required to amend the form of note (or other physical debt instrument) to include an OID legend.

[89] See Treas. Reg. § 1.1275-2(e). Cf. Treas. Reg. § 1.1273-2(f)(9), which now requires an issuer of debt instruments with an issue price determined by reference to the fair market value of publicly traded

The foregoing requirements should provide brokers, pricing services and holders with the information they will need to report deemed OID properly.[90]

property to make the issuer's determination of such issue price available to holders, in a commercially reasonable manner, no later than 90 days after such debt is issued.

[90] Under current law, there are situations in which the OID profile of an outstanding debt instrument can change midstream. These situations include the payment of PIK interest on PIK Toggle Notes and other modifications that change the yield of a debt instrument without resulting in a Deemed Reissuance (as discussed in Part III of this Report), as well as Deemed Reissuances that result from amendments of outstanding debt instruments (as opposed to actual exchanges for new debt instruments). In each of these existing situations, brokers, pricing services and holders rely on the issuer to provide revised OID information.

APPENDIX

This Appendix provides suggested regulatory language for implementing the recommendations made in the report.

I. Suggested language for new qualified reopening rules (a revised Treas. Reg. § 1.1275-2(k)):

(k) *Reopenings*. – (1) *In general*. – Notwithstanding §1.1275-1(f), additional debt instruments issued in a qualified reopening are part of the same issue as the original debt instruments. As a result, the additional debt instruments have the same issue date, the same issue price, and (with respect to holders) the same adjusted issue price as the original debt instruments. In addition, subject to the next sentence, for purposes of determining whether additional debt instruments are considered securities for purposes of sections 354 through 368 (the spinoff and reorganization rules), additional debt instruments shall be deemed to have been issued on the issue date of the original debt instruments. The preceding sentence shall not apply if the additional debt instruments were structured as a qualified reopening for a principal purpose of circumventing the requirement that the additional debt instruments qualify as securities for purposes of the spinoff and reorganization rules.

(2) *Definitions.* – (i) *Original debt instruments*. – Original debt instruments are debt instruments comprising any single issue of outstanding debt instruments. For purposes of determining whether a particular reopening is a qualified reopening, debt instruments issued in prior qualified reopenings are treated as original debt instruments and debt instruments issued in the particular reopening are not so treated.

(ii) *Additional debt instruments*. – Additional debt instruments are debt instruments (including existing debt instruments that are deemed reissued for U.S. federal income tax purposes (*e.g.*, pursuant to §§ 1.108-2, 1.1001-3 or 1.1502-13(g))) that, without the application of this paragraph (k) --

(A) Are part of a single issue of debt instruments as determined under paragraph (f)(1); and

(B) Are not part of the same issue as the original debt instruments.

The qualified reopening tests in paragraphs (k)(3)(ii), (k)(3)(iii) and (k)(3)(iv) will apply uniformly to all of the additional debt instruments, as if such debt instruments were all issued on the date on which the first such debt instrument is issued (for a price equal to the actual issue price of such first debt instrument).

(iii) *Reopening date*. – The reopening date is the issue date of the additional debt instruments (determined without the application of this paragraph (k)).

(iv) *Announcement date*. – Except as provided in the next sentence, if the issuer's intent to issue additional debt instruments is publicly announced, prior to the pricing date, through one or more media, including an announcement reported on the standard electronic news services

used by security broker-dealers (for example, Reuters, Telerate, or Bloomberg), the announcement date with respect to such additional debt instruments will be the later of (A) seven days before the pricing date of such additional debt instruments and (B) the date on which such intent is publicly announced. If, however, the issuer has a non-tax purpose for publicly reannouncing the issuer's intent to issue the additional debt instruments (*e.g.*, to alert the market that a reopening process that was postponed due to market conditions has resumed), and such reannouncement occurs prior to the pricing date, the issuer may instead treat the announcement date with respect to such additional debt instruments as the later of (A) seven days before the pricing date of such additional debt instruments and (B) the date of such reannouncement. If the issuer's intent to issue additional debt instruments is not publicly announced (or is not announced or reannounced (as applicable) prior to the pricing date), the announcement date with respect to such additional debt instruments will be the date that is seven days before the pricing date of such additional debt instruments.

(v) *CUSIP number* – A CUSIP number means a CUSIP, ISIN or similar identifying number or any other designation that identifies two or more debt instruments as having the same commercial terms and being treated for trading purposes as part of the same tranche of debt instruments.

(vi) *Commercial fungibility* – Additional debt instruments will be deemed commercially fungible with the original debt instruments if the additional debt instruments are viewed by holders as having the same commercial terms as the original debt instruments, as evidenced by the eligibility of such additional debt instruments, apart from U.S. federal income tax consequences, to trade under the same CUSIP number as the original debt instruments.

(vii) *Commercial fungibility testing date* – Except as provided in the next sentence, the commercial fungibility testing date with respect to any additional debt instruments will be the reopening date of such debt instruments. If, however, additional debt instruments are not intended to be commercially fungible with the original debt instruments until a date after the reopening date (a delayed fungibility date), the commercial fungibility testing date for such additional debt instruments will be the delayed fungibility date, provided that (A) such additional debt instruments are issued with the same payment terms as the original debt instruments (other than (1) one or more payment contingencies with respect to such additional debt instruments that may be ignored for purposes of § 1.1275-4 (*i.e.*, in determining whether such additional debt instruments will be treated as contingent payment debt instruments) and for purposes of determining the yield to maturity and OID accrual schedule of such additional debt instruments under § 1.1272-1(c) or (2) the existence or absence of pre-issuance accrued interest (within the meaning of § 1.1273-2(m)) but, for a non-tax purpose, are issued with other commercial terms that differ from the corresponding commercial terms of the original debt instruments, (B) at the time of issuance, it is reasonably expected that the delayed fungibility date will occur no later than one year from the reopening date, (C) the delayed fungibility date actually occurs (*i.e.*, such additional debt instruments become commercially fungible with the original debt instruments) no later than one year after the reopening date and (D) the changes to the commercial terms of such additional debt instruments do not result in a significant modification of such additional debt instruments for purposes of § 1.1001-3.

(viii) *Pricing date* – Except as provided in the next sentence, the pricing date of additional debt instruments is the first date on which the actual issue price of such debt instruments can be determined. If, however, (A) the original debt instruments are publicly traded as of the announcement date and (B) the additional debt instruments (1) are being offered pursuant to an exchange offer with fixed commercial terms or (2) are to be issued as consideration for an acquisition of property pursuant to an agreement (with fixed commercial terms) that will not sign and close simultaneously, the pricing date of such additional debt instruments will be the date on which the exchange offer is launched or the acquisition agreement is signed (as applicable), provided that the commercial terms of such issuance (including the consideration to be received in exchange for such issuance) do not change materially and the reopening date occurs no later than 45 business days after such pricing date plus a reasonable and customary settlement period. If there are material changes to the commercial terms of an exchange offer or acquisition agreement described in the preceding sentence, a new pricing date can be determined by reference to the date on which the revised commercial terms become fixed (subject to the requirements of the preceding sentence).

(ix) *Actual issue price* -- The actual issue price of additional debt instruments is their issue price, determined without the application of this paragraph (k).

(x) *Announcement date value* – The announcement date value of original debt instruments is the fair market value of such debt instruments as of the last business day before the announcement date of the applicable additional debt instruments. Such fair market value shall be determined by the issuer in accordance with the principles of § 1.1273-2(f)(5).

(xi) *Publicly traded* – Whether original debt instruments are considered publicly traded as of the announcement date shall be determined in accordance with § 1.1273-2(f), except that the relevant time period for testing such publicly traded status shall be the 15 day period ending on the last business day preceding the announcement date (in lieu of the 31 day period specified in § 1.1273-2(f)(1)).

(3) *Qualified reopening*. – (i) *Definitions*. – A qualified reopening is a reopening of original debt instruments that is described in paragraph (k)(3)(ii), (k)(3)(iii), or (k)(3)(iv) of this section. In addition, see paragraph (d)(2) of this section to determine if a reopening of Treasury securities is a qualified reopening.

(ii) *Reopenings within six months*. A reopening is described in this paragraph (k)(3)(ii) if --

(A) The reopening date is not more than six months after the issue date of the original debt instruments;

(B) Either:

(1) (I) the original debt instruments are publicly traded as of the announcement date of the additional debt instruments and (II) on the reopening date, the yield of the additional debt instruments, if their actual issue price equaled the announcement date value of the

original debt instruments, would not exceed 110%[91] of the yield of the original debt instruments on the reopening date (or, if the original debt instruments have no more than de minimis OID, 110% of the coupon rate of the original debt instruments on the reopening date); or

(2) on the reopening date, the yield of the additional debt instruments, based on their actual issue price, does not exceed 110% of the yield of the original debt instruments on the reopening date (or, if the original debt instruments have no more than de minimis OID, 110% of the coupon rate of the original debt instruments on the reopening date); and

(C) The additional debt instruments are commercially fungible with the original debt instruments on the applicable commercial fungibility testing date.

For purposes of subparagraph (k)(3)(ii)(B), the yield of the original debt instruments on the reopening date will be determined immediately after the reopening, taking into account any changes in the stated interest rate that occur in connection with the reopening (such as a reset of an applicable variable interest rate on the original debt instrument, or an increase in the interest rate resulting from the application of a most favored nation (MFN) clause in the original debt instrument). In the case of a variable rate debt instrument (VRDI), such yield should be determined as if the VRDI were a fixed rate debt instrument (in accordance with the principles of § 1.1275-5(e)), based on the applicable variable interest rate(s) in effect immediately after the reopening.

(iii) *Reopenings after more than six months.* A reopening is described in this paragraph (k)(3)(iii) if --

(A) The reopening date is more than six months after the issue date of the original debt instruments;

(B) Either:

(1) (I) the original debt instruments are publicly traded as of the announcement date of the additional debt instruments and (II) the announcement date value of the original debt instruments is not less than the adjusted issue price of the original debt instruments on the reopening date; or

(2) the actual issue price of the additional debt instruments is not less than the adjusted issue price of the original debt instruments on the reopening date; and

---

[91] As discussed in subsection B.3 of Part III of this Report, the references (in this suggested regulatory language) to "110% …" (in Treas. Reg. §§ 1.1275-2(k)(3)(ii)(B)(1) and (B)(2)) follow the approach of measuring the 10% Yield Cushion based on the yield of the original debt instruments as of the reopening date. Under the alternative approach (*i.e.*, measuring the 10% Yield Cushion based on the yield of the original debt instruments as of their issuance date), the language requiring the applicable yield not to exceed "110% …" should be changed to require the applicable yield not to exceed "100% … by more than the "10% yield cushion," and the "10% yield cushion" should be defined as "10% of the yield of the original debt instruments as of their issuance date."

(C) The additional debt instruments are commercially fungible with the original debt instruments on the applicable commercial fungibility testing date.

For purposes of this paragraph (k)(3), the adjusted issue price of the original debt instruments as of the reopening date will be determined in accordance with § 1.1275-1(b)(1), except that all previously accrued OID (including any such OID that holders are not required to include in income because such OID is considered de minimis) shall be taken into account (on a constant yield to maturity basis).

(iv) *Reopening with de minimis OID*. A reopening is described in this paragraph (k)(3)(iv) if --

(A) Either:

(1) (I) the original debt instruments are publicly traded as of the announcement date of the additional debt instruments and (II) the additional debt instruments, if they were issued on the reopening date with an actual issue price equal to the announcement date value of the original debt instruments, would be issued with less than a de minimis amount of OID; or

(2) the additional debt instruments, based on their actual issue price, are issued with less than a de minimis amount of OID; and

(B) The additional debt instruments are commercially fungible with the original debt instruments on the applicable commercial fungibility testing date.

(v) *The qualified reopening tests apply based on the tax treatment of the original debt instruments and additional debt instruments to holders.* – If, for U.S. federal income tax purposes, the original debt instruments or additional debt instruments are treated as having different terms with respect to the holders than with respect to the issuer, the qualified reopening tests (in paragraphs (k)(3)(ii), (k)(3)(iii) and (k)(3)(iv)) shall be applied based on the U.S. federal income tax treatment to the holders. Thus, for example, the application of the qualified reopening tests to an applicable debt instrument will not be affected by an election of the issuer to integrate such debt instrument with a hedge pursuant to § 1.1275-6.

(vi) *Exceptions.* – This paragraph (k)(3) does not apply to a reopening of tax-exempt obligations (as defined in section 1275(a)(3)) or contingent payment debt instruments (within the meaning of § 1.1275-4). In addition, this paragraph (k)(3) does not apply to additional debt instruments that, without the application of this paragraph (k), would be applicable high yield discount obligations within the meaning of section 163(i)(1) (AHYDOs), unless the applicable original debt instruments also are AHYDOs.

(4) *Issuer's treatment of a qualified reopening*.– See §1.163-7(e) for the issuer's treatment of the debt instruments that are part of a qualified reopening.

(5) *Effective/applicability dates*. – (i) Except as provided in paragraph (k)(5)(ii) of this section this paragraph (k) applies to debt instruments that are part of a reopening if the reopening date is on or after [ ].

(ii) Paragraphs [ ] of this section apply to debt instruments that are part of a reopening if the reopening date is on or after [ ].

II Suggested language for a new definition of "issue" (Treas. Reg. § 1.1275-1(f)(1)), with existing paragraphs (f)(1) through (f)(4) to be redesignated as paragraphs (f)(2) through (f)(5):

(f) *Issue.* – (1) *Debt instruments issued on or after [ ].* – Two or more debt instruments are part of the same issue if the debt instruments --

(i) Are commercially fungible when issued;

(ii) Are issued either pursuant to a common plan or as part of a single transaction or a series of related transactions;

(iii) Except as provided in paragraph (f)(5), are issued within a period of [fourteen] days beginning with the date on which the first debt instrument that would be part of the same issue is issued; and

(iv) Are issued on or after [ ].

For purposes of this paragraph (f)(1):

(A) *Issued.* -- A debt instrument is treated as issued on the date on which such debt instrument is treated as issued under general U.S. federal income tax principles. In general, the issue date of a debt instrument will be the date on which such debt instrument is funded and issued for commercial purposes, even if, on such date, the debt instrument is held by a bond house, broker, or similar person or organization acting in the capacity of an underwriter, placement agent, or wholesaler. If, however, the acquisition of debt instruments by an underwriter is structured with a principal purpose of circumventing the qualified reopening rules, the issue date of such debt instruments would instead be the date on which the underwriter resells a substantial portion of such debt instruments to persons not acting in the capacity of underwriters.

(B) *Commercial fungibility.* – Two or more debt instruments are commercially fungible if such debt instruments are eligible, apart from U.S. federal income tax consequences, to trade under the same CUSIP number.

If a debt instrument (a subsequently issued debt instrument) is considered part of the same issue as another debt instrument issued earlier in the same 13 day period, the subsequently issued debt instrument cannot also be part of an issue that includes debt instruments issued after the 13 day period (unless the later-issued debt instruments are treated as a qualified reopening of the debt instruments issued within the 13 day period).

III. Suggested language for a new exception to the 13 Day Rule for debt instruments issued pursuant to overallotment ("greenshoe") options (new Treas. Reg. § 1.1275-1(f)(5)), with redesignated paragraph (f)(5) further redesignated as paragraph (f)(6):

(5) *Debt instruments issued pursuant to an overallotment (greenshoe) option*—If any subsequently issued debt instrument is issued pursuant to an overallotment (greenshoe) option in respect of the first debt instrument that would be part of the same issue, paragraph (f)(1)(iii) shall be applied to such subsequently issued debt instrument by replacing the [fourteen] day period with a period of thirty days plus a reasonable and customary settlement period.

IV. Suggested language for a new uniform definition of "issue date" (which would replace the four existing definitions of "issue date" in Treas. Reg. §§ 1.1273-2(a)(2), (b)(2), (c)(2) and (d)(2)):

Issue Date. –Subject to the anti-abuse rule described below, the issue date of a debt instrument for purposes of Section 1273 is the date on which such debt instrument is treated as issued under general U.S. federal income tax principles. In general, the issue date of a debt instrument will be the date on which such debt instrument is funded and issued for commercial purposes, even if, on such date, the debt instrument is held by a bond house, broker, or similar person or organization acting in the capacity of an underwriter, placement agent, or wholesaler.

V. Suggested language for a revised Underwriter Rule (Treas. Reg. § 1.1273-2(e)):

(e) *Special rule for certain sales to bond houses, brokers, or similar persons.* For purposes of determining the issue price (but not the issue date) of a debt instrument under this section, sales to bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers are ignored.

VI. Suggested language for a revised small issuance exception (Treas. Reg. § 1.1273-2(f)(6)):

(6) *Exception for small debt issues.* -- Notwithstanding any other provision in paragraph (f) of this section, a debt instrument will not be treated as traded on an established market if at the time the determination is made the outstanding stated principal amount of the issue that includes the debt instrument does not exceed US$100 million (or, for a debt instrument denominated in a currency other than the U.S. dollar, the equivalent amount in the currency in which the debt instrument is denominated). For purposes of applying the preceding sentence to additional debt instruments (as defined in § 1.1275-2(k)(2)(ii)), the applicable original debt instruments (as defined in § 1.1275-2(k)(2)(i)) shall be treated as part of the same issue as such additional debt instruments.

VII. Suggested language for a new Deemed OID Election (new Treas. Reg. § 1.1275-2(l)):

(l) *Deemed OID elections.* --

(1) *In general.* – Subject to the conditions set forth in paragraph (l)(3), an issuer of additional debt instruments that are commercially fungible with original debt instruments on

the applicable commercial fungibility testing date, but are otherwise ineligible to be a qualified reopening, may make a deemed OID election to treat the original debt instruments as having been reissued on the reopening date for a deemed reissuance price equal to the actual issue price of the additional debt instruments (or, if the additional debt instruments are treated as a qualified reopening of other original debt instruments, for a deemed reissuance price equal to the adjusted issue price of such other original debt instruments as of the reopening date).

(2) *Effect of Election.* -- (A) A deemed OID election shall apply for purposes of (1) determining the amount of OID to be recognized by holders of the original debt instruments from and after the reopening date and (2) applying the provisions of § 1.1275-2(k) and § 1.1275-1(f)(1) to the applicable reopening and any subsequent reopenings of the original debt instruments. The original debt instruments would not be deemed reissued for purposes of determining whether the original debt instruments are contingent payment debt instruments (CPDIs) within the meaning of § 1.1275-4 (*i.e.*, CPDI status would not have to be retested). The increased OID resulting from a deemed OID election shall apply to holders for all purposes of the Internal Revenue Code, and shall also apply to issuers and other parties to the extent such parties are required to act as withholding agents with respect to any OID of such holders (including pursuant to Sections 1441, 1442 or 1471 through 1474) or are subject to information reporting obligations with respect to any OID of such holders (including pursuant to Sections 1461 through 1464 or 6049). For all purposes of the market discount rules (Sections 1276 through 1278), a deemed OID election shall cause a holder of an original debt instrument to be treated as having exchanged such debt instrument (in a non-recognition transaction in which no gain or loss will be recognized) for a deemed new original debt instrument with an issue price equal to the deemed reissuance price.

(B) Except as provided in subparagraph (A), a deemed OID election will not have any U.S. federal income tax consequences. Thus, for example, a deemed OID election will result in no U.S. federal income tax consequences to the issuer and will not result in a realization event, or the recognition of any immediate income, gain, loss or deduction to any holder. Similarly, a deemed OID election would not result in a modification of the original debt instruments for purposes of § 1.1001-3, and would not be taken into account in determining whether the original debt instruments were issued with significant original issue discount for purposes of Section 163(i)(2).

(3) *Conditions for making an election.* – An issuer may make a deemed OID election with respect to original debt instruments only if:

(i) such election is needed to cause additional debt instruments to have the same U.S. federal income tax consequences as the original debt instruments (and thereby have the same CUSIP number as the original debt instruments (either as of the reopening date or as of a delayed fungibility date));

(ii) the deemed reissuance price of the original debt instruments would be less than the adjusted issue price of the original debt instruments on the reopening date absent

the election (*i.e.*, only if the election will increase the amount of OID to be recognized by holders with respect to the original debt instruments));

(iii) the deemed reissuance price of the original debt instruments would be no less than [93-95]% of the adjusted issue price of such original debt instruments as of the reopening date, determined without regard to the deemed OID election (and any prior deemed OID elections); and

(iv) the terms of the original debt instruments (as reflected in the applicable credit agreement, securities purchase agreement, indenture or other governing document) (A) expressly permit the issuer to make deemed OID elections with respect to the original debt instruments and (B) provide that a holder, by purchasing an original debt instrument, is deemed to have agreed to report such holder's income in a manner consistent with any such deemed OID elections.

Any original debt instruments that do not satisfy the requirements of clause (iv) at the time of issuance may be amended to allow deemed OID elections, as long as the amendment is disclosed in any prospectus or other offering document pursuant to which the amendment is marketed to holders.[92]

Subject to the conditions of this paragraph (l)(3), a deemed OID election may be made more than once with respect to the same original debt instruments.

(4) *Time and manner of making the election.* – An issuer must make a deemed OID election with respect to any original debt instruments no later than 30 days after the applicable reopening date. The election must be made by filing a properly completed and executed Internal Revenue Service [Form __ (Deemed OID Election Form)] with the internal revenue office with which the issuer files its U.S. federal income tax return. The issuer must attach a copy of such completed and executed form to the issuer's timely filed U.S. federal income tax return for the taxable year of the issuer that includes the reopening date, but the failure to attach such copy shall not invalidate the election.

(5) *Issuer's reporting and disclosure requirements.* – An issuer that makes a deemed OID election with respect to any original debt instruments (i) shall be subject to the provisions of § 1.1275-3 with respect to the deemed reissuance of such debt instruments and (ii) shall be required (A) no later than 30 days after the applicable reopening date, to provide written notice of such election to all holders of record of the original debt instruments on the reopening date and (B) no later than 90 days after the applicable reopening date, to make available to holders in a commercially reasonable fashion, including by electronic publication, the applicable reopening date, the deemed reissuance price, the amount of

[92] As discussed in Part VI of this Report, Treasury might instead decide (1) to allow amendments that permit Deemed OID Elections, but only if the original debt instruments were initially issued for commercial purposes after the date on which rules permitting Deemed OID Elections are promulgated or (2) to prohibit Deemed OID Elections unless such elections are authorized when the original debt instruments are initially issued for commercial purposes (so that each investor can decide independently whether it wishes to own a debt instrument that permits Deemed OID Elections).

deemed OID, the revised yield to maturity and an accrual schedule with respect to the deemed OID.

(6) *Revocation of election.* – A deemed OID election may not be revoked without the consent of the Commissioner.

(7) *Terms defined in the qualified reopening rules.* – Terms not defined in this § 1.1275-2(l) that are defined in § 1.1275-2(k) (the qualified reopening rules) shall have the same meanings specified in the qualified reopening rules.

VIII. Suggested new language for Treas. Reg. § 1.1001-3 to address Deemed OID Elections (a new Treas. Reg. § 1.1001-3(c)(6) (with current Treas. Reg. § 1.1001-3(c)(6) to be renumbered as Treas. Reg. § 1.1001-3(c)(7))):

(6) *Deemed OID elections.* – A deemed OID election (as defined in § 1.1275-2(l)) with respect to an original debt instrument (as defined in § 1.1275-2(k)(2)(i)) is not a modification of such debt instrument. Similarly, an amendment to the terms of an original debt instrument to permit (or prohibit) deemed OID elections with respect to such debt instrument is a not a modification of such debt instrument.