NEW YORK STATE BAR ASSOCIATION TAX SECTION

REPORT ON PROPOSED REGULATIONS ON THE DEFINITION OF PUBLIC TRADING

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TABLE OF CONTENTS

Report No. 1237

New York State Bar Association Tax Section

Report on Proposed Regulations on the Definition of Public Trading

I. Introduction

This report comments on proposed regulations (the "Proposed Regulations") issued on January 6, 2011 interpreting when property is treated as "traded on an established securities market" (or "publicly traded") for purposes of determining the issue price of a debt instrument.[1]

The existing regulations defining public trading were issued in 1994. Trading in debt instruments has evolved significantly since then. As a result, the definition under the existing regulations is outdated and taxpayers face numerous ambiguities in applying the existing regulations. We are grateful that the government has recognized difficulties in interpreting the current rules and has taken steps to provide clearer guidance.

We begin our comments, again, with a request to provide relief from cancellation of debt income ("CODI"), as we did in our report on public trading submitted on March 30, 2010 (the "2010 Report").[2] Under the current tax law, the measurement of CODI is directly linked to whether or not debt is publicly traded. While the new definition of public trading under the Proposed Regulations has the advantage of being clear and straight-forward, it would entail the consequence of making it more likely for an issuer of an illiquid debt instrument to recognize CODI in a debt-for-debt exchange or a debt modification, because the new definition is more likely to result in deeming the debt instrument publicly traded than under the current definition.

We are also concerned that taxpayers would often not have easy access to information that they need in order to apply the new definition. Under the Proposed Regulations, whether a debt instrument is publicly traded or not depends on the existence of actual prices and/or quotes and the volume of trades. Unless a debt instrument is registered with the SEC, however, information regarding trades, quotes or prices of the debt instrument is kept private by the parties involved in the transaction, and is generally not released to the public. Accordingly, we believe that it is critical to provide for certain procedural standards and presumptions in order for taxpayers to be able to comply with the new rule. Regarding the definition of public trading

[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 drafter of this letter was Jiyeon Lee-Lim, with substantial assistance from Matthew Dewitz and Craig Horowitz. Helpful comments were received from Lee Allison, Douglas Borisky, Michael Farber, Edward Gonzales, Robert Kantowitz, Charles Kingson, Stephen Land, Lisa Levy, Jason Lippek, John Lutz, Vadim Mahmoudov, David Miller, John Narducci, Andrew Needham, Erika Nijenhuis, Elliot Pisem, Larry Salva, Michael Schler, David Schnabel, David Sicular, Andrew Walker and W. Kirk Wallace.

[2] The New York State Bar Association submitted two reports on the definition of "traded on a established securities market" under Section 1273, first on August 12, 2004 and recently on March 30, 2010.

itself, we think that its scope needs to be clarified and limited in a few respects. Lastly, we recommend a few additional technical changes to the qualified reopening rules that would be amended under the Proposed Regulations.

A summary of our principal recommendations is as follows:

1. We strongly recommend that the Treasury exercise its authority under Sections 446(b) and 7805(a)[3] and require a matching of the CODI and the deduction of the OID accruing on the new debt instrument in a debt-for-debt exchange (including a deemed exchange). We also recommend that the Treasury extend the application of Notice 2010-11,[4] or adopt similar relief, for all debt instruments issued in an exchange that meet certain conditions.

2 Alternatively, we recommend that the Treasury provide a special rule that the issue price of the new debt instrument in a debt-for-debt exchange is equal to the lesser of the issue price determined under the principles of Section 1274 and the adjusted issue price of the old debt instrument, whether or not the old debt instrument or the new debt instrument is publicly traded.

3. We recommend that the final regulations provide that a sales price or quote for property must provide a reasonable basis to determine fair market value in order for the property to be treated as publicly traded.

4. We recommend that the final regulations clarify that for purposes of Treasury Regulations Sections 1.1273-2(f)(4) and (5), a price quote must be a bona fide price quote to a third party to buy and sell (or must be based on such bona fide quote), must be available to the issuer or the holder who is determining the issue price of the debt instrument in question and must exist independently of any inquiry the issuer or the holder makes in connection with the issue price determination.

5. We recommend that the final regulations describe various factors that taxpayers may consider in establishing fair market value when there are multiple quotes or prices. In addition, we recommend the final regulations provide that if there are multiple quotes or values available, the averaging of the quotes or values for a period that is within the testing period should be considered a reasonable method.

6. We recommend that, in the event the Treasury does not adopt our recommendation that a sales price or quote for property must provide a reasonable basis to determine fair market value in order for the property to be deemed publicly traded (our recommendation under item (3) above), the special rule in Proposed Regulations Section 1.1273-2(f)(6)(ii) be expanded to all types of prices and quotes so that taxpayers are permitted to rebut the presumption that any particular price or quote equals fair market value if it materially misrepresents fair market value.

[3] Section references are to the Internal Revenue Code of 1986, as amended (the "Code"), unless otherwise indicated.

[4] 2010-4 I.R.B. 326.

7. We recommend that the final regulations provide that property must be "traded" on an exchange in order for the property to be treated as publicly traded by virtue of listing on an exchange.

8. We recommend the final regulations clarify that a sales price exists within the meaning of Proposed Regulations Section 1.1273-2(f)(3)(i) only if the purchase and sale of the property occurs, and the sales price is reasonably available, during the testing period.

9. We recommend that the de minimis trading exception be elective relief and not a mandatory provision. We also recommend that the final regulations clarify that the issuer's determination that the debt instrument qualifies for the de minimis trading exception is respected so long as the issuer has made reasonable efforts to find about trades. We also recommend the final regulations provide that transfers of "participations" are generally ignored unless the issuer knows of facts relating to participations that would cause the de minimis trading exception not to apply.

10. We recommend that the final regulations provide that the small debt issue exception be applied based on the principal amount outstanding as of the relevant issue date.

11. We recommend that the final regulations explicitly provide that the issue price determined by the issuer based on sales prices, quotes, the volume of trades or other information reasonably available to the issuer, including information available to the issuer upon a reasonably diligent inquiry, at the time of the determination of the issue price is respected.

12. We recommend that the final regulations provide that the issuer must determine the issue price of a debt instrument issued in exchange for property within a reasonable period, and must make its determination available to holders by taking reasonable notification measures. A holder should be bound by the issuer's determination unless it discloses its inconsistent position in the holder's tax return.

13. For the qualified reopening rules, we recommend that an issuer be permitted to satisfy the 110% yield test (for a reopening within six (6) months), a 100% yield test (for a reopening after six (6) months) or the de minimis test (for a reopening at any time) on either the announcement date (based on the public trading price of the original debt on that date) or the reopening date (based on the actual cash offering price of the additional debt).

II. Mitigation of the CODI Issue

The determination of the issue price of a debt instrument issued in exchange for property is important to the issuer and the holders for several different reasons. One of the main consequences is that the issuer may recognize CODI or retirement premium if the debt is treated as publicly traded and is trading at a discount or a premium. For example, if an existing debt instrument is exchanged for a new debt instrument (or if the existing debt is significantly modified to result in a deemed exchange with a new debt instrument under Section 1001) and if either the old debt instrument or the new debt instrument is publicly traded, the old debt instrument is treated as retired for the fair market value of the publicly traded debt instrument and the new debt instrument is treated as issued for such amount, thereby causing the issuer to realize CODI if such fair market value is less than the amount outstanding on the old debt instrument. While the issuer will benefit from deductions of the original issue discount ("OID") on the new debt instrument that accrues over time, there may be a significant mismatch in the timing of the CODI inclusion and the OID deduction and, in certain circumstances, a portion of the OID deduction may be permanently disallowed under the rules governing applicable high yield debt obligations ("AHYDO").

Section 108(a) provides some relief for the CODI. If the issuer is insolvent or bankrupt, it may exclude the CODI from income. However, as we have witnessed for the last several years, during an economic downturn or widespread market disruption, much debt, and not just debt of an insolvent or bankrupt issuer, would trade at a significant discount. Section 108(i) provided for additional, albeit temporary, relief for CODI recognized from a debt-for-debt exchange in 2009 and 2010, whereby taxpayers were permitted to make an election to defer the CODI and effectively match the CODI recognition with the OID deductions. The application of the AHYDO rules was also suspended for those exchanges. However, Section 108(i), as well as the suspension of the AHYDO rules, have now expired.

Due to this potential CODI issue that is directly linked to the definition of public trading, the scope of the definition of public trading has always been a very significant issue for taxpayers. As the Proposed Regulations adopt a broader definition, one of the unfortunate consequences would be the exacerbation of the CODI issue. More taxpayers would recognize phantom CODI than under the old definition when they experience no accretion to wealth because they pay the same or a greater amount going forward.

We understand that the government's view is that the CODI issue is an issue separate from the definition of public trading under Section 1273, and is not something that should be resolved by narrowing the definition of public trading. Even if a narrower definition were adopted, as long as there are some debt instruments that are treated as publicly traded, the potential inequity and hardship relating to CODI would still fall on those issuers whose debt is so treated.

We agree with the government that CODI is an issue that should be dealt with separately from the definition of public trading. As we reported in several of our prior reports, we believe that the government should provide separate, systematic relief for the CODI issue. We also believe that providing such relief would not be inconsistent with the Congressional intent behind the repeal of prior Section 1275(a)(4) and the adoption of Section 108(e)(10).[5]

1. Matching of CODI with OID under Section 446(b) authority.

One possible solution is to permit the amount of any CODI recognized in a debt-for-debt exchange (unless attributable to a reduction in the stated or imputed principal amount of the debt) to be amortized over the term of the instrument as an offset to the corresponding amount of

[5] See the 2010 Report, at 14-19.

OID deductions created by the discount in the issue price.[6] We believe that such amortization of CODI is not inconsistent with the Congressional intent behind the repeal of Section 1275(a)(4) and the adoption of Section 108(e)(10). The main reason that Congress expressed in repealing Section 1275(a)(4) and enacting Section 108(e)(10) was the concern that taxpayers could pick the form of transaction in order to fit their tax planning and take tax positions most favorable to their particular tax situations.[7] Nothing in the legislative history of the repeal of Section 1275(a)(4) or the enactment of Section 108(e)(10) indicates that Congress focused on the current inclusion of the entire CODI.

We strongly believe that the Treasury has regulatory authority under Sections 446(b) and 7805(a) to provide for this treatment. Section 446(b) provides that if the method of tax accounting used by a taxpayer does not clearly reflect income, taxable income is computed under such method as, in the opinion of the Treasury, clearly reflects income. Treasury Regulations Section 1.446-1(a)(2) further provides that "no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income."

We believe that when an exchange of a publicly traded debt instrument for a new debt instrument creates both income in the form of CODI and deductions in the form of OID in an equal amount while the debt amount remains the same, matching the inclusion of such income

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[6] The NYSBA Tax Section has recommended this relief in several of its reports. See the New York State Bar Tax Section, "Report on Revenue Procedure 2008-51," January 20, 2009 (the "2008 Report"), at 13-15; the 2010 Report, at 14-16.

[7] The New York State Bar Tax Section report on March 25, 1991, "Provisions of the Revenue Reconciliation Act of 1990 Affecting Debt-For-Debt Exchanges" (the "1991 Report"), addressed the impact of the Revenue Reconciliation Act of 1990 (the "1990 Act") on debt-for-debt exchanges. The 1990 Act added the predecessor of Section 108(e)(10)(B) to the Code and repealed Section 1275(a)(4). Section 1275(a)(4), prior to its repeal, provided that the issue price of the new instrument in a debt-for-debt exchange that qualified as a corporate reorganization was equal to the "adjusted issue price" of the old debt instrument if it is greater than the issue price otherwise determined under Sections 1273 and 1274. That section was intended to prevent the creation of OID or CODI in a debt-for-debt exchange that qualified as a corporate reorganization, but also gave rise to unintended abuse by taxpayers. For example, some issuers were able to avoid CODI by claiming recapitalization treatment and carrying over the adjusted issue price of the old debt instrument when there was a reduction in the principal amount of their debt in connection with a debt-for-debt exchange.

"It is understood that taxpayers take various positions as to whether and how these OID and other rules apply for purposes of determining COD. With respect to exchanges that qualify as reorganizations, taxpayers with net operating losses, or in title 11 or similar proceedings may take the position that the OID rules do not apply, so that COD is created. In such exchanges, taxpayers in other situations may take the position that the OID rules do apply, so that no COD is created. … The rules for determining the amount of COD created on a debt-for-debt exchange need to be clarified in order to provide guidance to taxpayers, to ensure similar treatment for taxpayers undertaking similar transactions, and to prevent taxpayers from selectively choosing the tax treatment for a transaction." H.R. Rep. No. 101-37, at 83 (1990).

and the corresponding deductions is consistent with a clear reflection of income. But for the public trading of the debt instrument, the issuer would not have incurred the CODI or the OID deductions.

The Supreme Court has confirmed that the Treasury has wide discretion to establish methods of tax accounting that clearly reflect income.[8] This exercise of discretion should be available even where a method of accounting is not mandated by the Code but results in clear reflection of income.[9] Although Section 446(b) itself does not explicitly provide the Treasury with authority to issue rules and regulations, such authority is found in Section 7805(a), which provides that the Treasury "shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue."[10]

A recent Supreme Court case, Mayo Foundation for Medical Education and Research v. U.S., 131 S.Ct. 704 (Jan. 11, 2011), further supports this point. In Mayo Foundation, the Supreme Court applied the principles announced in Chevron U.S.A. Inc v. Natural Resources Defense Counsel, Inc., 467 U.S. 837 (1984), in upholding certain regulations issued by the Treasury under Section 7805(a), "[b]ecause it is one to which Congress has not directly spoken, and because the Treasury Department's rule is a reasonable construction of what Congress has said."[11] Referring to the Treasury's authority to issue regulations under Section 7805(a), the Supreme Court also said: "Our inquiry in that regard does not turn on whether Congress's delegation of authority was general or specific… We have found such 'express congressional

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[8] U.S. v. Hughes Properties, Inc., 476 U.S. 593 (1986); Thor Power Tool Co., v. Comm'r, 439 U.S. 522 (1979); Hansen v. Comm'r, 360 U.S. 446 (1959); Lucas v. American Code Co., 280 U.S. 445 (1930).

[9] Johnson v. Comm'r, 184 F.3d 786 (8th Cir. 1999) (where accrual basis taxpayer deferred recognition of income attributable to amount received for a vehicle service contract that was put into an escrow account until repairs were performed or the contract was terminated, Commissioner did not exceed his broad powers when he determined that the method of accounting used by the taxpayer did not clearly reflect income); In re EWC, Inc., 114 F.3d 1071 (10th Cir. 1997) (holding that, although Section 448 precluded the taxpayer from using the cash method, the Internal Revenue Service (the "IRS") was permitted to use the cash method because it clearly reflected income). See also Rev. Proc. 2001-10, modifying Rev. Proc. 2000-22 and modified by Rev. Proc. 2011-14 (stating that the IRS exercised discretion under Section 446(b) and Section 471 to except certain taxpayers from the requirement to account for inventories and to allow them to use the cash method of accounting to account for sales of merchandise, which normally must be accounted for on an accrual basis).

[10] Section 7805(a).

[11] "The principles underlying our decision in Chevron apply with full force in the tax context. … Filling gaps in the Internal Revenue Code plainly requires the Treasury Department to make interpretive choices for statutory implementation at least as complex as the ones other agencies must make in administering their statutes. … We see no reason why our review of tax regulations should not be guided by agency expertise pursuant to Chevron to the same extent as our review of other regulations." Mayo Foundation, supra.

authorization to engage in the process of rule making' to be 'a very good indicator of delegation meriting Chevron treatment.'"[12]

The Treasury has previously issued regulations under Section 446(b) that require the matching of income and deductions. Treasury Regulation Section 1.446-3, for example, prescribes specific accounting rules governing the timing of reporting income, deduction, gain and loss related to notional principal contracts, requiring that income associated with non-periodic payments be taken into account over the duration of the contract, rather than at the time of the payment or receipt.[13] Similarly, Treasury Regulation Section 1.446-4 prescribes the accounting method that must be used to account for hedging transactions, requiring that income, deduction, gain or loss be reported on a basis that matches the timing of the income, deduction, gain or loss from the item being hedged, rather than simply when realized.[14]

We strongly recommend that the Treasury exercise its authority under Sections 446(b) and 7805(a) and require a matching of the CODI and the deduction of the OID accruing on the new debt instrument in a debt-for-debt exchange (including a deemed exchange). Such measure will achieve the clear reflection of income and, at the same time, alleviate hardship on the issuers. If the matching principle is adopted, it should equally apply when a debt instrument is retired at a premium in a debt-for-debt exchange (or a deemed exchange) as well. Thus, any such premium should be required to be amortized over the term of the debt instrument, which would essentially offset the reduction of the interest deductions on the new debt instrument caused by the repurchase premium.[15]

We also recommend the Treasury consider providing special relief from the AHYDO rules for a debt instrument issued in a debt-for-debt exchange, under which such debt instrument is not treated as an AHYDO if it would not have been an AHYDO absent the decrease in market value. Section 163(i)(1)(B) provides that AHYDO means any debt instrument if the maturity is more than 5 years and "the yield to maturity on such debt instruments" equals or exceeds the applicable federal rate plus 5%. Section 163(i)(5) provides:

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[12] The Supreme Court has held that regulations "must be sustained unless unreasonable and plainly inconsistent with the revenue statutes" and that "the role of the judiciary in cases [challenging the validity of an interpretive regulation] begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable fashion." Comm'r v. South Tex. Lumber Co., 333 U.S. 496, 501 (1948) ("must be sustained"); U.S. v. Correll, 389 U.S. 299, 307 (1967) ("role of the judiciary").

[13] Treas. Reg. Section 1.446-3(f)(2) (nonperiodic payments generally must be recognized over the term of a notional principal contract in a manner that reflects the economic substance of the contract); see Preamble to Prop. Treas. Reg. Section 1.446-3, 2004-1 C.B. 655 (addressing method of accounting for contingent nonperiodic payments).

[14] Treas. Reg. Section 1.446-4(b).

[15] See Treas. Reg. Section 1.163-7. Retirement premium is already required to be amortized if the issue price of the new debt instrument is determined under Section 1273(b)(4) or 1274.

"The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this subsection and subsection (e)(5), including – (A) regulations providing for modifications of the provisions of this subsection and subsection (e)(5) … where such modifications are appropriate to carry out the purposes of this subsection and subsection (e)(5)."

We think that one way to provide the necessary relief is to extend the application of Notice 2010-11,[16] or adopt a similar rule, for all exchanges. Under Notice 2010-11, whether or not a new debt instrument issued in a debt-for-debt exchange has a yield in excess of the threshold for an AHYDO is measured based on a hypothetical issue price equal to the issue price of the new debt instrument increased by the amount of CODI recognized in the exchange. This is a very sensible rule, and we strongly recommend that the Treasury consider applying it to all debt exchanges. We do not believe Congress intended to apply the AHYDO rules to a debt instrument that would not otherwise be an AHYDO but for the fluctuation in fair market value measured as of the time when the debt instrument is exchanged for a new debt instrument or goes through a significant modification. Rather, we believe the true economic yield to the issuer is probably what Congress intended to measure under the yield test described above. In this regard, measuring the yield for purposes of the AHYDO rules based on the sum of the issue price of the new debt instrument and the CODI recognized in the exchange would bring the measurement closer to the true economics. For example, under the special rule, if an old debt instrument with a principal amount of $100 was originally issued at par for cash with adequate stated interest and is exchanged with a new debt instrument with the same principal amount of $100 when the debt instrument is publicly traded at $80, the issue price of the new debt instrument will be $80 and the issuer will recognize CODI of $20. For purposes of the AHYDO rules, however, the yield on the new debt instrument would be computed using $100 as the issue price ($80 of the new issue price plus $20 of CODI) instead of the issue price of the new debt instrument.

Such special rule would in many cases reduce the mismatch between the CODI and the OID deductions that may otherwise arise in a debt-for-debt exchange or a significant modification involving a publicly traded debt instrument. We believe that such a rule, combined with the amortization of CODI under Sections 446(b) and 7805(a) discussed above, would be sensible, given the broader definition of public trading under the Proposed Regulations.

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[16] We note that several conditions must be met in order for a debt obligation to be a "qualified obligation" under Notice 2010-11. One of them is that the holder of the debt obligation must not be a related person within the meaning of Section 108(e)(4). If the Treasury considers extending the relief, it may reconsider this condition, as there seems to be no reason to disqualify related parties from the relief. The Notice also requires that the original debt obligation must not be an AHYDO in order to be a qualified obligation. Such requirement may lead to a harsh result where the original debt obligation was an AHYDO but the issuer was able to avoid deferral of deductions under the AHYDO rules by electing to pay interest in cash. One of the solutions would be to suspend the application of the AHYDO rules to the extent of any increase in the yield resulting from any discount in the trading value (which should generally equal the amount of CODI).

2. Special rule to determine issue price of debt issued in a debt-for-debt exchange.

Another alternative to alleviate the CODI issue is to revise the existing issue price rules under the authority given under Section 1275(d).[17] Section 1275(d) authorizes the Treasury to issue regulations to modify the tax treatment prescribed by Sections 1271 through 1275 (the "OID rules") (and Section 163(e) to the extent appropriate) to carry out the purposes of the OID rules. Section 1275(d) has been utilized previously by the Treasury in connection with issuance of regulations for contingent payment debt instruments and variable rate instruments. We believe that the language of Section 1275(d) permits the Treasury to issue regulations in circumstances where the relevant provisions of the Code may produce a different result, if the purpose of the regulations is to appropriately carry out the purpose of the OID rules.[18] More specifically, we believe that Section 1275(d) authorizes the Treasury to revise the existing issue price rules under Section 1273 as such Section applies to debt-for-debt exchanges to better align the purpose of the OID rules with the CODI provisions of the Code.

The Treasury could specify that the issue price of the new debt instrument in a debt-for-debt exchange is equal to the lesser of the issue price determined under the principles of Section 1274 and the adjusted issue price of the old debt instrument, whether or not the old debt instrument or the new debt instrument is publicly traded.[19] By providing that it is the lesser of the issue price under Section 1274 and the old debt instrument's adjusted issue price, the rule addresses situations where the old debt instruments had OID or the debt's principal amount is reduced as a result of a debt-for-debt exchange. If an old debt instrument was issued at par with adequate stated interest, so long as the stated principal amount of the debt instrument remains unchanged and there is still adequate stated interest, the exchange of the old debt instrument for a new debt instrument should not give rise to any tax consequences to the issuer merely because the instrument is publicly traded. So long as there is adequate stated interest, the new debt instrument would be treated as having been issued at its face amount.

Under the proposed approach, a holder who purchased a publicly traded debt instrument at a discount in the market will generally recognize gain upon the exchange unless the exchange

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[17] See T.D. 8674 (issuing Final Treasury Regulations Sections 1.1275-4 and 1.1275-6).

[18] Section 1275(d) states that "[T]he Secretary may 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 (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))" The "subpart" referred to is subpart A of Part V of subchapter P. Subpart A contains Sections 1271 through 1275.

[19] The 1991 Report recommended that Congress reenact Section 1275(a)(4) and expand it to cover all debt-for-debt exchanges involving a single issuer, whether or not they constitute reorganization and whether or not the issuer was a corporation. Our recommendation to provide a special issue price in a debt-for-debt exchange to be equal to the lesser of the issue price determined under Section 1274 and the adjusted issue price under the old debt is generally in line with our recommendation in our 1991 Report.

qualifies as a tax-free recapitalization. If the exchange qualifies as a tax-free recapitalization, under the proposed approach, the discount (except for any existing OID) would remain as market discount (generally not taxable until paid) to the holder, which would be the same result as in the absence of the exchange. Under current law, even if the exchange does not qualify as a tax-free recapitalization, the discount will remain as market discount so long as the debt instrument is treated as publicly traded and continues to trade at the same discounted value.

If the Treasury decides to adopt the Section 1275(d) approach, it should consider anti-abuse rules to prevent any artificial triggering of CODI in situations that are inconsistent with the purpose of the new provision, which is to narrow the cases where CODI is triggered. For example, if an issuer with expiring net operating losses is engaged in a debt modification with respect to a debt instrument trading at a discount, it may want to trigger CODI rather than avoid it. In that case, the issuer may first repurchase the old debt instrument in the market at its fair market value and then, pursuant to the same plan, issue a new debt instrument with the same principal amount to the same investors (or substantially the same investors). In order to prevent such abuse, the Treasury may consider providing a special anti-abuse rule under which if there is a substantial overlap between the holders of the old debt instrument and the holders of the new debt instrument and if the repurchase and the new issuance are part of the same plan, two transactions are treated together as an exchange.[20]

III. Clarifications and Limitations Needed for the New Definition

1. A sale price or quote should provide a reasonable basis to determine fair market value.

Under the Code, the issue price of a debt instrument equals its fair market value if the debt instrument or property for which the debt is issued is publicly traded. Otherwise, its issue price is determined under Section 1274. Congress intended that the issue price be equal to fair market value if it is easily and readily determinable, and Congress thought that fair market value is easily and readily available if property is publicly traded. In other words, Congress thought that public trading would produce a reliable indication of fair market value.

The Proposed Regulations treat property as publicly traded if <u>any</u> sales price <u>or</u> a quote is available during the 31-day period ending 15 days after the issue date (the "testing period") subject to certain de minimis exceptions. As a result, even if a price or quote does not provide a reasonable basis to determine fair market value, the mere fact that the price or quote exists either for the debt instrument or the property for which the debt instrument is issued would require that the issue price be equal to the fair market value of the debt instrument.

In normal circumstances, a sales price or quote would reflect the fair market value of the property. However, in highly illiquid markets, when the market is not orderly due to unforeseen events, when the sale is not arm's length for whatever reason, when there is only a quote to buy

[20] We note that the issuer may have some electivity in planning in that by selling the new debt instruments in the market to unrelated parties, it could avoid the application of the special issue price rule. However, we believe such transaction should be respected, given unrelated parties are involved.

or quote to sell (but not both), or when the spread is more than commercially reasonable even if there are quotes to buy and to sell, then the sales price or quote may not reflect the fair market value. For example, if a security is illiquid, brokers and dealers may post "quotes" but there may be a very wide spread between bid and ask, making it difficult to determine fair market value based on such quotes. In these situations, the sales price or quote of a property may not reflect its fair market value.[21]

The Proposed Regulations take the position that the existence of a single quote or price indicates there is an "established market" and therefore "public trading". And, once viewed as publicly traded, the issue price of the debt instrument must be determined based on fair market value. As such, the Proposed Regulations do not take into account in the analysis whether that one quote or price provides any reliable indication of fair market value.

We recognize that defining "public trading" in a clear way that avoids ambiguity is important. Attempting to draw a line between the types of quotes or prices that demonstrate public trading on one hand, and those that do not on the other hand, especially in the ever changing and evolving market, is difficult and may lead to ambiguities. In that regard, the definition provided under the Proposed Regulations has the advantage of a bright-line test and being straightforward in concept.[22]

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[21] Financial Accounting Standard 157 provides rules for defining fair value for accounting purposes, under which fair value means a price that would be received in an "orderly" transaction. An "orderly" transaction is generally defined as a transaction that (a) assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities and (b) is not a forced transaction (for example, a forced liquidation or distressed sale).

[22] While not exactly analogous, it is helpful to compare the definition of public trading under the Proposed Regulations with the definition of "liquid assets" under the recent proposed rule implementing section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Volcker Rule"). The definition of a "liquid asset" under the Volcker Rule is similar to, but more restrictive than, the definition of "public trading" under the Proposed Regulations. Under such rule, a "liquid asset" is defined as:

- Cash or cash equivalents;
- Any asset that is traded on a recognized, established exchange, trading facility or other market on which there exist independent, bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for the asset almost instantaneously;
- Any asset for which there are bona fide, competitive bid and offer quotations in a recognized inter-dealer quotation system or similar system or for which multiple dealers furnish bona fide, competitive bid and offer quotations to other brokers and dealers on request;
- Any asset the price of which is quoted routinely in a widely disseminated publication that is readily available to the general public or through an electronic service that provides indicative data from real-time financial networks;

Nevertheless, a substantial majority of the members of the Tax Section believe that, as a fundamental matter, the Code divides the issue price determination into two categories – one for which there is public trading, as a proxy for those for which there is reliable indication of fair market value easily available to taxpayers, and the other for which there is no public trading, as a proxy for those for which there is no reliable, readily available, indication of fair market value. That is, if market information does not provide proper indication of fair market value, the relevant property should not be deemed publicly traded.

Accordingly, we recommend that the final regulations provide that the price or quote for property must provide a reasonable basis to determine fair market value in order for the property to be treated as publicly traded.[23] In this regard, we believe that a quote should not be treated as providing a reasonable basis to determine fair market value unless there are both a quote to buy and a quote to sell and the spread between them is commercially reasonable. Financial accounting principles governing fair market value (such as Financial Accounting Standard 157) may be used in determining whether the price or quote provides a reasonable basis to determine fair market value. If this alternative is adopted, in order to minimize ambiguities in applying the rule, the burden should be on the taxpayer to establish, based on reasonably available information, that the available sales price or quote for a property does not provide a reasonable basis to determine fair market value in order to take the position that the property is not publicly traded.[24]

2. A quote should be an independently existing bona fide quote to buy and sell, and available to the taxpayer.

Under Proposed Regulations Sections 1.1273-2(f)(4) and (5), property is treated as publicly traded if at any time during the 31-day period ending 15 days after the issue date, "a *price quote is available from at least one broker, dealer, or pricing service* (including a price provided only to certain customers or to subscribers) for property" (emphasis added). A price quote can either be a firm quote or an indicative quote. Under the Proposed Regulations, if the

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- Any asset with an initial term of one year or less and the payments on which at maturity may be settled, closed-out, or paid in cash or one or more other liquid assets described above; and
- Any other asset that the Federal Reserve Board determines, based on all the facts and circumstances, is a liquid asset.

Illiquid assets (i.e., assets that are not liquid assets) are generally given an extended transition period for complying with the requirements under the Volcker Rule.

[23] Our recommendation is essentially consistent with the recommendation in the 2010 Report regarding indicative quotes. In the 2010 Report, we recommended that for indicative quotes to be considered indicia of public trading, they must provide a reasonable basis to determine fair market value.

[24] A minority among the members of the Tax Section expressed their view that no modification to this provision of the Proposed Regulations is necessary, and the existence of a quote or a sales price should be sufficient indication that the property is publicly traded (unless a de minimis rule applies).

quoted price is substantially the same as the price for which the property could be purchased or sold and the identity of the person providing the quote is reasonably ascertainable, the quote is considered a firm quote. All other quotes are considered indicative quotes.

There is some ambiguity as to whether any price quote is a price quote for this purpose. There is also ambiguity as to what “being available” means, and whether “being available” includes “becoming available” upon inquiry by issuers, holders or others where the sole purpose of the inquiry is to determine the public trading status of the relevant property.

With respect to a “price quote”, we believe that a quote must be bona fide. Additionally, a quote must be a quote provided to third parties to buy or sell, or a price derived from those quotes. For example, an internal valuation study done by an investor or a potential investor solely to assess performance of its portfolio or to make internal projections, standing alone, should not count as a price quote.

We also believe that “being available” in this context should mean “available” to the issuer and/or the holder that is making a reasonable inquiry to determine the issue price. Furthermore, “being available” should not be mere ability to obtain, but must mean that, independently of the issue price determination and inquiry with respect thereto, there exists a bona fide quote to buy or sell (or a price quote based on such quotes) from a broker, dealer or pricing service out there in the market. If no such quote is otherwise available, the fact that an issuer, holders or other relevant parties may inquire about the existence of such quote, alone, should not cause a quote to be deemed to exist for this purpose. That is, the inquiry made to a broker, dealer or pricing service in this regard should be whether any bona fide quote to buy or sell already exists for the property (independent of the inquiry) and should not be whether anyone would be able to obtain a quote for the property from a broker, dealer or pricing service.[25]

We think it is important to recognize that the availability of a quote in this context is used as a proxy for “public trading”. Interpreting the phrase “being available” as mere ability to obtain would mean that virtually all properties would be considered publicly traded without regard to any indicia of any market activities, as one would almost always be able to obtain a quote on a property if needed. Such a broad interpretation would be inconsistent with the requirement under the Code that property be “traded on an established securities market”. In order to support some indicia of market trades, we believe, at a minimum, independent buy and sell quotes should exist in the market.

Accordingly, we recommend that the final regulations clarify that for purposes of Proposed Regulations Sections 1.1273-2(f)(4) and (5), a price quote must be a bona fide price quote to a third party to buy and sell (or must be based on such bona fide quotes), must be available to the issuer or the holder who is determining the issue price of the debt instrument in question, and must exist independently of any inquiry relating to the issue price determination.

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[25] The 2010 Report recommended quotes be “readily available”. Our recommendation in this letter is consistent with, and is further articulation of, our recommendation in the 2010 Report.

3. Guidance is needed as to a reasonable method in determining the issue price when there are multiple prices or quotes.

When there are multiple prices and quotes available, Proposed Regulations Section 1.1273-2(f)(6)(i) allows taxpayers to "use any reasonable method, consistently applied" to determine the price. However, it is unclear which methods will be considered reasonable. It is also ambiguous what "consistently applied" means in this context. We recommend that the final regulations provide guidance in this regard.

When it comes to determining fair market value, we do not believe any one method is necessarily better than other methods. In the same vein, while we believe that sales prices should generally carry more credence than quotes and firm quotes more than indicative quotes, a strict hierarchy would be too rigid.

Accordingly, we recommend that the final regulations describe various factors that taxpayers may consider in establishing fair market value when there are multiple quotes or prices. Those factors should include: (i) whether the available price is an actual sales price, firm quote or indicative quote; (ii) the frequency and the source of the price or quote, (iii) the timing of the relevant trade, sale or quote in relation to the issue date, (iv) whether the price or quote results from a bona fide transaction between unrelated parties, and (v) the size of the relevant trade or quote. So long as the determination of the issue price is not unreasonable under the relevant facts and circumstances, the determination by the issuer (or the holder who makes its own determination regarding the issue price and discloses such position) should be respected. In addition, we recommend the final regulations provide that if there are multiple quotes or values available, the averaging of the quotes or values for a period that is within the testing period should also be considered a reasonable method.

We also recommend the final regulations clarify that "consistently" applying a reasonable method means general consistency by each taxpayer in the same or similar fact pattern or regarding the same debt instrument, and does not mean that the issuer must use the same specific method in all fact patterns for different debt instruments.

4. Taxpayers should be permitted to rebut the presumption that actual prices or firm quotes equal fair market value.

The Proposed Regulations generally presume that prices and quotes equal the fair market value of the relevant property. However, the Proposed Regulations permit a taxpayer to rebut this presumption in the case of indicative quotes. Under Proposed Regulations Section 1.1273-2(f)(6)(ii), if an indicative quote materially misrepresents fair market value and there are no sales prices or firm quotes available, then a taxpayer may use an alternative "reasonable method" for determining fair market value.

If the Treasury adopts our above recommendation that a price or a quote for property must provide a reasonable basis to determine fair market value in order for property to be considered publicly traded, the applicability of Proposed Regulations Section 1.1273-2(f)(6)(ii) would be narrowed. In such event, we expect that if any price or quote materially misrepresents fair market value, such price or quote alone would not cause the property to be deemed publicly traded.

If, however, the Treasury does not adopt our above recommendation and keeps the concept in the Proposed Regulations that the mere existence of any price or quote (regardless of whether such price or quote provides a reasonable basis to determine fair market value) would cause the property to be deemed publicly traded, we believe that with respect to not only an indicative quote, but also a sales price or firm quote, taxpayers should have the opportunity to rebut the presumption established in Proposed Regulations Section 1.1273-2(f)(6)(i).

As discussed, a sales price represents the fair value of the property only if the sale is an orderly transaction between a willing buyer and a willing seller. If it is a forced sale, the sales price could materially misrepresent the value of the property. In addition, if there is only a firm quote to buy or a firm quote to sell, but not both, or if there is more than a commercially reasonable spread between the two firm quotes, such quotes may likewise materially misrepresent fair market value.

Therefore, we recommend that, in the event the Treasury does not adopt our recommendation to provide that a sales price or quote for property must provide a reasonable basis to determine fair market value in order for the property to be deemed publicly traded, the special rule in Proposed Regulations Section 1.1273-2(f)(6)(ii) be expanded to all types of prices and quotes so that taxpayers are permitted to rebut the presumption that any particular price or quote equals fair market value if it materially misrepresents fair market value.

5. The per se public trading for listing on an exchange should be amended.

Proposed Regulations Sections 1.1273-2(f)(1)(i) and (f)(2) provide that property is deemed to be "traded on an established market" if it is listed on a national securities exchange registered under Section 6 of the Securities Exchange Act or on a foreign securities market that is officially recognized, sanctioned, regulated or supervised by a governmental authority of the foreign country in which the market is located. Mere listing of property alone, however, does not provide any indication of what fair market value for the property is. Accordingly, we believe that the rule should be amended to require "trading" on the exchange for the property to be treated as publicly traded by virtue of listing on an exchange.

Foreign issuers list their debt instruments on foreign exchanges to accomplish various objectives, including to qualify for exemption from local withholding tax or to make their debt instruments eligible for purchase by certain regulated investors in Europe. For example, under the so-called "quoted Eurobond exemption", interest paid on a debt instrument issued by an issuer in the United Kingdom, Ireland or Spain will be exempt from local withholding if the debt instrument is listed on a qualifying stock exchange and certain other conditions are met. Listing on an exchange subjects the issuer to certain reporting and filing requirements, but there is frequently no minimum trading requirement for a listing on a foreign exchange. Sometimes, the sole or primary owner of such Eurobonds is an affiliate of the issuer. As such, notes that are listed on a foreign exchange will often be purchased and sold in privately negotiated transactions in the same way as those that are not so listed, and the fact that notes are listed will have no bearing on whether the prices or the quotes are more available to the public. Similarly, for U.S.

domestic exchanges, the number of debt instruments being listed on a domestic exchange has steadily declined. Even if a debt instrument is listed on a U.S. domestic exchange, most trading occurs outside of the exchange in private transactions, unless the debt is registered with the SEC.[26]

Setting aside the listing on an exchange prong, if a sales price or quote is available for property, Proposed Regulations already treat such property as publicly traded. Thus, if there is some price or quote available, the property would be treated as publicly traded. If property is "listed" on an exchange but there is no trading on the exchange and no actual price or quote is available, we believe such property should not be treated as publicly traded. Otherwise, the property would be treated as publicly traded even if there is no price or quote available to determine fair market value.[27]

While we recognize that a de minimis trading exception may provide relief, as discussed below, it may often be very difficult for taxpayers to utilize the exception due to the lack of access to the information regarding the volume of actual trades: Either it would be difficult to establish the lack of trades, or, if there is a trade, no one but the seller and the buyer would likely have access to the sales price if the transaction is private. As such, we believe that a bond merely listed on a foreign exchange for which there is no information available regarding the sales price or quote should not be treated as publicly traded. It would be unreasonable if a taxpayer has to come up with fair market value when there is no indication of any price.

Therefore, we recommend that the final regulations provide that property must be "traded" on an exchange in order for the property to be treated as publicly traded.

6. The sales price should be deemed to exist only if the sale takes place, and the sales price is reasonably available, during the testing period.

Proposed Regulations Section 1.1273-2(f)(3)(i) states that a sales price exists for property "if the price for an executed purchase or sale of the property is reasonably available." We recommend that the final regulations clarify that a sales price exists under such section only if the relevant purchase or sale occurs during the relevant testing period and the sales price is also available during the relevant testing period.

If a sale takes place outside of the relevant testing period, it is not a reliable measure of fair market value as of the issue date.[28] Therefore, we think that the regulation should clarify that the relevant sale or purchase must take place within the testing period. At the same time, the underlying sale price should also be reasonably available during the testing period. Otherwise, the issue price determination would be left undecided after the testing period.

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[26] See the 2010 Report, Appendix, at 1-3.

[27] Cf. Treas. Reg. Section 1.1296-2(c), defining term "qualified exchange or other market" for purposes of applying the mark-to-market rules under Section 1296.

[28] TRACE publishes on its websites the trade history (usually going back for one (1) year) of debt instruments registered with the SEC. Even if there are no recent trade activities, the TRACE website would show old trades and their trading prices.

Therefore, we recommend the final regulations clarify that a sales price exists only if the purchase or sale of the property occurs, and the sales price is reasonably available, during the testing period.

7. De minimis trading exception

Proposed Regulations Section 1.1273-2(f)(7) states that property will not be treated as publicly traded if there is no more than de minimis trading of the property. Under Proposed Regulations Section 1.1273-2(f)(7)(ii), a debt instrument is treated as traded in de minimis quantities only if (i) each trade during the testing period is for an amount of $1 million or less (or an equivalent amount of non-U.S. dollar currency) and (ii) the aggregate amount of all such trades during the testing period does not exceed $5 million (or an equivalent amount of non-U.S. dollar currency). Under this exception, even if price information is available in the market, the property would not be treated as publicly traded, <u>if</u> it can be established that there were no trades (or only de minimis trades) during the testing period.

While we agree with the concept, we are concerned that it will be a challenge for taxpayers to find out whether there are actual trades in the relevant debt. Unless a debt instrument is registered with the SEC, trading information is generally not publicly disseminated. Securities traded through a book-entry system held at a clearing system, such as DTC, Euroclear or Clearstream are mostly held by street names, and their trades often occur beyond the clearing system's book-entry system, at the participant or sub-participant level. For example, a bank may often buy a large portion of a security under one street name and divide its holding among its own account, its clients and various funds it manages. Any trades among sub-accounts of a bank will be recorded in the bank's internal book entry and will not be revealed to any outsiders. Broker-dealers making a market would know the trades that they handle, but would not know about trades handled by other broker-dealers. While trades taking place on the PORTAL market (involving securities eligible for resale under SEC Rule 144A ("144A securities")) are required to be reported to TRACE, unless the security is registered with the SEC, TRACE will not disseminate the trade information to the public. If the security is registered with the SEC, however, TRACE generally disseminates the trade information to the public. For loans, the administrative agent for a loan would normally be required to maintain a register to record the identity of each lender and their interest in the loan as well as assignments of interest in the loan. However, loan agreements customarily limit access to the register to only the borrower and the administrative agent. Lenders will have no access to the information on the register. Furthermore, when a lender sells participations in a loan, neither the borrower nor other lenders will have access to the participant register maintained by the lender selling the participation. Unlike trades on the PORTAL market, the loan trading pricing will not be reported to TRACE and its pricing will be kept strictly confidential.

In order for the de minimis trading rule to be practically applicable and serve its purpose, it is critical that the final regulations clarify the level of diligence required of an issuer in establishing the exception. We think that the rule should be that the issuer must make reasonable efforts to find out about the trades, including making inquiries to the original underwriters, initial purchasers, loan arrangers, dealer managers, placement agents, administrative agents and others acting in a similar capacity. If these inquiries do not identify trades in excess of the de minimis trading thresholds, and if the issuer does not know or have reason to know of any other trades that would prevent the debt from qualifying for the de minimis trading exception, then the issuer's determination that the debt instrument qualifies for the de minimis trading exception should be respected. We also believe that transfers of "participations" should be generally ignored unless the issuer knows of facts relating to participations that would cause the de minimis trading exception not to apply. The sale of participations is generally kept confidential outside the parties directly involved in the purchase and sale of participations. Thus, we believe it is reasonable for an issuer to ignore the participations in the absence of actual knowledge to the contrary. It is also noted that the purchase price of participations is generally lower than the purchase price for assignments. As such, even if the sale of participations is known to the issuer, the sales price for participations would likely not provide a reasonable basis to determine fair market value.

It is also unclear whether the de minimis trading exception is a mandatory or elective provision. We strongly believe it should be elective. Given the difficulty involved in the fact finding, if an issuer is unable to establish the number and size of trades or is not confident about the relevant facts, the issuer should be permitted to elect not to rely on the exception. (As discussed below, such position of the issuer should bind the position of the holders unless a holder discloses its inconsistent position in its tax return.)

Accordingly, we recommend that the final regulations clarify that the de minimis trading exception be elective relief and not a mandatory provision. We also recommend that the final regulations clarify that the issuer's determination that the debt instrument qualifies for the de minimis trading exception should be respected so long as the issuer has made reasonable efforts to find out about the trades, including making inquiries to the original underwriters, initial purchasers, loan arrangers, dealer managers, placement agents, administrative agents and others acting in a similar capacity, and the issuer does not know or have reason to know of any other trades that would prevent the debt from qualifying for the de minimis trading exception. In this regard, we also recommend the final regulations provide that transfers of "participations" are generally ignored in establishing de minimis trading unless the issuer knows of facts relating to participations that would cause the de minimis trading exception not to apply. Holders should be permitted to rely on the issuer's determination that the de minimis trading exception is met. Conversely, if the issuer determines that the de minimis exception does not apply, such determination should also bind the holders.

8. The small debt issue exception should be measured against the currently outstanding principal amount as of the issue date.

Proposed Regulations Section 1.1273-2(f)(8) provides another exception from public trading for debt issued with an "original stated principal amount" that does not exceed $50 million. We agree with this exception. However, we believe that the relevant principal amount should not be the original stated principal amount, but rather the currently outstanding stated principal amount as of the relevant issue date. For example, if a debt instrument had an original stated principal amount of $300 million, but only $20 million is outstanding four years later on the date of a significant modification of the debt instrument, we believe the debt instrument should qualify for the small debt issue exception on the date of the significant modification. At the time of the significant modification, the original size of the debt issue is no longer relevant and should not affect whether the remaining $20 million of debt instrument should be treated as publicly traded.

Accordingly, we recommend that the final regulations provide that the small debt issue exception is applied based on the principal amount outstanding as of the relevant issue date.

9. Issue price should be determined as of the issue date.

There is potential inconsistency regarding the timing of the fair market value determination. Treasury Regulations Sections 1.1273-2(b)(2) and (b)(3) require that issue price reflect the fair market value of the relevant property "as of the issue date." However, Proposed Regulations Section 1.1273-2(f)(6) presumes that a price or quote equals fair market value and requires a taxpayer to use the price or quote in determining the issue price, without regard to when in the testing period the price or quote arose. We agree with the government that taxpayers should be able to rely on reasonably available prices or quotes without adjustment, when they provide a reasonable basis to determine fair market value. However, we also believe that if the taxpayer has a reasonable basis to conclude that the fair market value as of the issue date is different from the sales price or quote from a different date, taxpayers should be permitted to use reasonable methods to adjust prices or quotes to arrive at the fair market value as of the issue date.

Accordingly, we recommend that the final regulations clarify that if the available actual sales price or quote is from a date different from the issue date and if the taxpayer has a reasonable basis to conclude that the fair market value as of the issue date is different from such sales price or the quote, taxpayers may use reasonable methods to modify such price or quote in order to arrive at the fair market value as of the issue date.

10. Anti-abuse rule should be expanded.

Proposed Regulations Section 1.1273-2(f)(9) provides an anti-abuse rule targeting taxpayers who attempt either to prevent debt instruments from being treated as publicly traded or to generate artificial prices or quotes that misrepresent fair market value. While it is much less likely that taxpayers will attempt to intentionally cause a debt instrument to be treated as publicly traded than the other way around, we believe that certain reverse anti-abuse rules are also needed to prevent taxpayers from artificially causing their debt instruments to be publicly traded. For example, a taxpayer may create related party sales exceeding the de minimis threshold to cause the debt instrument to be publicly traded, when the issue price would otherwise be determined under Section 1274.

Accordingly, we recommend that the final regulations add a reverse anti-abuse rule providing that if there is any temporary trading or quoting a principal purpose of which is to cause the property to be traded on an established market for federal income tax purposes, then the trading or quoting may be disregarded.

11. When there are multiple issues of debt instruments with identical terms, public trading of one issue should be viewed as public trading of the other issue.

The Proposed Regulations apply the definition of public trading on an issue-by-issue basis. There may be multiple debt instruments issued by the same issuer with identical terms in all respects, which are not technically the same "issue" for tax purposes. In such event, we believe that public trading of one issue should establish public trading of such other issue having identical terms. As discussed, however, if there are characteristics of an issue that may affect the fair market value of that particular issue, the issuer should be permitted to make adjustments.

12. Reasonable determination by issuer or holder should be respected.

The implementation of the definition of public trading under the Proposed Regulations is premised on the ability of taxpayers to find out whether sales prices or quotes exist or not and what the prices or quotes are.

As discussed above, however, in the current market, other than securities that are registered with the SEC, information relating to actual trades or actual trading prices of the securities is kept private. Securities traded through a book-entry system held at a clearing system, such as DTC, Euroclear or Clearstream (including almost all 144A securities) are mostly held by street names, and their trades often occur beyond the clearing system's book-entry system. While all trades in 144A securities through the PORTAL market are required to be reported to TRACE, unless the securities are registered with the SEC, TRACE does not release the actual trade information. For loans, while the administrative agent for a loan would normally be required to maintain a register to record the identity of each lender and their interest in the loan, loan agreements customarily limit the access to the register to only the borrower and the administrative agent. The register will record the amount of the loan traded and the assignor and the assignee, but will not record the sales price. The actual sales price will be kept confidential by the parties involved in the sale. Other holders of the loan whose tax consequences may depend on the issue price of the loan ordinarily cannot obtain information kept on the register. In addition, when a lender sells participations in a loan, neither the borrower nor other lenders will ordinarily have access to the participant register maintained by the lender. Moreover, even if the occurrence of a trade is recorded or reported, the actual sale price of the bond or loan is always kept confidential between the buyer and the seller, unless the security is registered with the SEC (in which case TRACE would disseminate the sales price). As a result, it is very often difficult for issuers and holders to find out about the existence of trades, and almost impossible to find out the trading prices of a debt instrument, unless they are directly involved in the trades.

Compared with actual sale prices, it may be easier to find quotes. Price quotes are often disseminated by dealers, brokers and pricing services to subscribers, clients or potential customers through BLOOMBERG and other various trading platforms or through loan pricing services. However, even for quotes, issuers and holders will normally not have access to such pricing services or trading platforms through which the quotes are distributed. As we discussed in detail in the 2010 Report, the subscribers or members of the trading platform and the pricing services are usually bound by various types of confidentiality agreements.

Given the difficulty that issuers and holders face in ascertaining the existence of trades or quotes or prices or size, we believe it is critical to provide some reasonable determination standard so that taxpayers can comply with the rule without undue burden.

Accordingly, we recommend that the final regulations explicitly provide that the issue price determined by the issuer based on sales prices, quotes, the volume of trades or other information reasonably available to the issuer (or the holder who establishes the issue price on its own and disclose it in its return), including information available to the issuer (or such holder) upon a reasonably diligent inquiry, at the time of the determination of the issue price should be respected.

13. Issuer must determine and provide the issue price; holders must be bound by (and may rely on) the issuer's determination unless they disclose otherwise.

The Proposed Regulations are silent on who should determine the issue price. Given the difficulty in gathering relevant facts for determining the issue price, as well as the potential for inconsistent positions, we believe that an issuer (including a foreign issuer that is subject to OID information reporting under Treasury Regulations Section 1.1275-3(d)) should be required to determine the issue price of a new debt instrument issued (or deemed issued) in exchange for property and make the issue price available to the holders. We also think that the issuer should be permitted to amend the issue price within a reasonable period of time, for example, in the event the issuer subsequently discovers additional facts that are contrary to the issuer's initial determination. A holder should be bound by the issuer's determination of the issue price unless the holder discloses the inconsistent position in its tax return, and may assume the issuer's determination of the issue price is correct.

The current legending and information reporting requirement relating to OID under Treasury Regulations Section 1.1275-3 fails to achieve effective channeling of information relating to OID. For a debt instrument that is not publicly offered, OID legending is required only if a debt instrument is issued in physical form. Because almost all 144A bonds are traded through a certificate-less book entry system, even if there is a physical note, the legending on a physical note is not shown to any holder. A physical note is rarely issued in a bank loan. Therefore, we think that a different method may need to be employed in order for the issue price to be effectively conveyed to holders. For example, the issuer can mail the information to each holder utilizing the notice provisions in the documents governing the relevant security, post it on the Web, or provide, in the document governing the new debt instrument (or the amended loan agreement), the contact information of a representative who will provide the issue price upon request.

In the event the issuer fails to provide the issue price to the holders, a holder will then have to determine the issue price on its own. Or, a holder may want to establish an issue price that is different from the issuer's determination, by disclosing such position in its return (except when the issuer has determined that the de minimis trading exception does not apply). In such case, a holder should be able to use the same reasonable inquiry and reasonably available information standards as the issuer, and a holder's determination based on information reasonably available to it should be respected.

Accordingly, we recommend that the final regulations provide that (a) the issuer must determine the issue price of a debt instrument issued (or deemed issued) in exchange for property within 90 days following the testing period, (b) the issuer must make its determination available to holders by taking reasonable measures, such as mailing of such information in accordance with the relevant notice provisions, posting on the Web, or providing holders with the contact information for a representative who will provide the issue price upon request, (c) a holder should be bound by the issuer's determination unless it discloses the inconsistent position in the holder's tax return, and may assume the issuer's determination of the issue price is correct, and (d) a holder making its own determination of the issue price must make such determination applying the same reasonable standards that apply to the issuer.

IV. Comments on Qualified Reopening Rules

The Proposed Regulations with respect to qualified reopenings are a constructive step towards furthering the policy of the qualified reopening rules, which is "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."[29] We believe the changes suggested below would also make the qualified reopening rules more responsive to current capital market practices without compromising the concern about converting OID into market discount.

First, qualified reopenings should be permitted more than six-months after an initial debt offering, even if the additional debt would have more than de minimis OID as a stand-alone issue, if the yield on the debt instrument at the time of the reopening is no higher than the yield on the debt instrument when it was originally issued. We suggest that the 110% yield test currently applicable to reopenings within six months of the original offering also apply to reopenings outside the six-month window, substituting "100%" for "110%." This standard 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 into market discount. We do not see any logical reason for prohibiting such a reopening.

After the qualified reopening regulations were first proposed in 1999, some commentators requested that a yield test be applied after the six-month window, but the request appears to have been for a yield test in excess of 100% that would have allowed some conversion of OID into market discount.[30] As noted above, a 100% yield test would allow no such conversion. Moreover, reopenings outside the six-month window are not uncommon in the current market environment and a 100% yield test would be particularly beneficial at this time -- while trading prices of debt instruments in general have improved recently, the trading prices of many debt instruments issued a year or two ago at a steep discount have not improved enough to satisfy the de minimis test.

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[29] Preamble to Prop. Treas. Reg. § 1.1275-2(k), 1999-2 C.B. 583, 584.

[30] See T.D. 8934, 2001-1 C.B. 904, 907 ("Some of the commentators suggested that the final regulations allow a reopening occurring after the expiration of the fixed reopening period to be a qualified reopening if the reopening satisfies a yield test that would limit the amount of OID converted into market discount.").

A 100% yield test would also address a technical glitch in the current de minimis test in the case of debt instruments that have OID not because they were issued at a discount, but because some of their stated interest is not qualified stated interest. The de minimis test is not well suited to discount notes (which accrue non-cash yield for the first several years and thereafter provide for cash interest) or PIK toggle notes because, in such cases, additional notes will have more than de minimis OID even if the additional notes are issued at or above par (or accreted value).

To allow an issuer to have certainty at the beginning of the reopening process that qualified reopening treatment will apply, we recommend that an issuer be permitted to satisfy the 110% yield test, the new 100% yield test or the de minimis test (as applicable) on either the announcement date (based on the public trading price of the original debt on that date)[31] or the reopening date (based on the actual cash offering price of the additional debt). Treasury recognized the importance of this issue when it revised and finalized the 1999 proposed regulations in 2001. The 1999 proposed regulations required an issuer to satisfy a two-part yield test: a 107.5% yield test based on trading of the original debt seven days before the reopening debt was priced and a 115% yield test based on the actual pricing of the reopening debt. This two-pronged test could have disqualified a reopening based on changes in the market price of the debt instrument after the reopening process had commenced. The 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 issue coming to market.[32]

We also recommend that the existing de minimis OID test be retained for offerings within and outside of the six-month window. The de minimis OID test would continue to be relevant in a situation where neither the original debt nor the additional debt is issued with more than de minimis OID, but the applicable yield test (either 110% or 100%) is not satisfied because the price of the debt instrument has declined since its original offering. While additional debt issued in such a case should be considered fungible with the original debt (even if the two tranches are

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[31] We believe that the purpose for the public trading requirement is to condition the issuer's ability to test qualified reopening status on the announcement date (i.e., at the beginning of the reopening process) on the existence of a reliable price to use in applying the yield test. Accordingly, we suggest that the publicly traded status of the original debt be tested on the announcement date, not the reopening date.

[32] "Commentators suggested that the two-part yield test be replaced with a single yield test. According to the commentators, by 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 would be caused by unexpected market volatility), a cancelled reopening could generate lost economic costs for these capital market participants. In addition, the second test would create marketing and credibility concerns for issuers." T.D. 8934, supra, at 906.

technically considered to be two separate “issues”), it would be helpful to eliminate any uncertainty on this point.

Appendix 1 includes suggested language for revised Treasury Regulations Section 1.1275-2(k)(3)(ii) and (iii) that incorporates both the changes made in the new Proposed Regulations and our suggested changes.

Appendix 1

Suggested language for revised Treas. Reg. §§ 1.1275-2(k)(3)(ii) and (iii):

(ii) *Reopening within six months*. A reopening is described in this paragraph (k)(3)(ii) if the reopening date is not more than six months after the issue date of the original debt instruments and either (A) or (B) below is satisfied:

(A) (1) The original debt instruments are publicly traded (within the meaning of § 1.1273-2(f)) as of the date on which the price of the additional debt instruments is established or, if earlier, the announcement date (the "reopening testing date"); and

(2) Either (a) the yield of the original debt instruments on the reopening testing date (based on their fair market value) is not more than 110 percent of the yield of the original debt instruments on their issue date (or, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate) or (b) the additional debt instruments would be issued with no more than a *de minimis* amount of OID (determined without the application of this paragraph (k)) if the additional debt instruments were issued for cash equal to the fair market value of the original debt instruments on the reopening testing date.

(B) (1) The additional debt instruments are issued for cash to persons unrelated to the issuer (as determined under section 267(b) or 707(b)) for an arm's length price; and

(2) Either (a) the yield of the additional debt instruments (based on their cash purchase price) is not more than 110 percent of the yield of the original debt instruments on their issue date (or, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate) or (b) the additional debt instruments are issued with no more than a *de minimis* amount of OID (determined without the application of this paragraph (k)).

(iii) *Reopening after six months*. A reopening is described in this paragraph (k) (3)(iii) if the reopening date is more than six months after the issue date of the original debt instruments and either sub-paragraph (k)(3)(ii)(A) or sub-paragraph (k)(3)(ii)(B) would be satisfied if "100 percent" were substituted for "110 percent" in such sub-paragraph.