

REPORT #711

TAX SECTION

New York State Bar Association

Letter on Repeal of Section 1275(a)(4)

February 14, 1992

**Table of Contents**

Cover Letter :.....	i
I. INTRODUCTION .....	2

# TAX SECTION

## New York State Bar Association

**OFFICERS**

**JOHN A. CORRY**  
Chair  
1 Chase Manhattan Plaza  
New York City 10005  
212/530-4608

**PETER C. CANELLOS**  
First Vice-Chair  
299 Park Avenue  
New York City 10171  
212/371-9200

**MICHAEL L. SCHLER**  
Second Vice-Chair  
Worldwide Plaza  
825 Eighth Avenue  
New York City 10019  
212/474-1588

**CAROLYN JOY LEE ICHEL**  
Secretary  
30 Rockefeller Plaza  
New York City, NY 10112  
212/903-8761

**COMMITTEES CHAIRS****Bankruptcy**

Stuart J. Goldring, New York City  
Dennis E. Ross, New York City

**Compliance and Penalties**

Robert S. Fink, New York City  
Arnold Y. Kapiloff, New York City

**Consolidated Returns**

Yaron Z. Reich, New York City  
Irving Salem, New York City

**Continuing Legal Education**

Brookes D. Billman, Jr., New York City  
Thomas V. Glynn, New York City

**Corporations**

Richard L. Reinhold, New York City  
Dane Trier, New York City

**Estate and Trusts**

Kim E. Baptiste, New York City  
Steven M. Loeb, New York City

**Financial Instruments**

Jodi J. Schwartz, New York City  
Esta E. Stecher, New York City

**Financial Intermediaries**

Bruce Kayle, New York City  
Hugh T. McCormick, New York City

**Foreign Activities of U.S. Taxpayers**

Stanley I. Rubinfeld, New York City  
Steven C. Todrys, New York City

**Income from Real Property**

Stephen L. Millman, New York City  
Michelle P. Scott, Newark, NJ

**Individuals**

Michael Hirschfeld, New York City  
Sherry S. Kraus, Rochester

**Net Operating Losses**

Jeffrey M. Cole, New York City  
Kenneth H. Heitner, New York City

**New York City Tax Matters**

Robert J. Levinsohn, New York City  
Robert Plautz, New York City

**New York State Tax Matters**

Robert E. Brown, Rochester  
James A. Locke, Buffalo

**Nonqualified Employee Benefits**

Stephen T. Lindo, New York City  
Loran T. Thompson, New York City

**Partnerships**

Joel Scharfstein, New York City  
R. Donald Turlington, New York City

**Pass-Through Entities**

William B. Brannan, New York City  
Thomas A. Humphreys, New York City

**Practice and Procedure**

Donald C. Alexander, Washington, D. C.  
Victor F. Keen, New York City.

**Qualified Plans**

Stuart N. Alperin, New York City  
Kenneth C. Edgar, Jr., New York City

**Reorganizations**

Robert A. Jacobs, New York City  
Richard M. Leder, New York City

**Sales, Property and Miscellaneous**

E. Parker Brown, II, Syracuse  
Paul R. Comeau, Buffalo

**State and Local**

Arthur R. Rosen, New York City  
Sterling L. Weaver, Rochester

**Tax Accounting Matters**

Elliot Pisem, New York City  
Mary Kate Wold, New York City

**Tax Exempt Bonds**

Linda D'Onofrio, New York City  
Patti T. Wu, New York City

**Tax Exempt Entities**

Harvey P. Dale, New York City  
Franklin L. Green, New York City

**Tax Policy**

Andrew N. Berg, New York City  
Victor Zonana, New York City

**Tax Preferences and AMT**

Katherine M. Bristor, New York City  
Stuart J. Gross, New York City

**U.S. Activities of Foreign Taxpayers**

Roger J. Baneman, New York City  
Kenneth R. Silbergleit, New York City

**MEMBERS-AT-LARGE OF EXECUTIVE COMMITTEE**

M. Bernard Aidinoff	Cynthia G. Beerbower	Edward D. Kleinbard.	Charles M. Morgan, III	Eugene L. Vogel
Reuven Avi-Yonah	William M. Colby	James A. Levitan	Ronald I. Peariman	David E. Watts
David H. Bamberger	Harold R. Handler	Richard O. Loengard, Jr.	Mikel M. Rollyson	Philip R. West

February 14, 1992

The Honorable Dan Rostenkowski  
Chair, House Ways & Means Committee  
House of Representatives  
Rayburn 2111  
Washington, DC 20515

The Honorable Lloyd Bentsen  
Chair, Senate Finance Committee  
United States Senate  
Hart 703  
Washington, DC 20510

Dear Sirs:

On March 25, 1991, the New York State Bar Association Tax Section submitted the report of its Ad Hoc Committee on Provisions of the Revenue Reconciliation Act of 1990 Affecting Debt for Debt Exchanges (the "Report"). The Report was reprinted in Tax Notes, and I have enclosed a copy. In that Report, the committee stated its view that the repeal of section 1275(a)(4) of the Internal Revenue Code of 1986, as amended (the "Code"), by section 11325(a) of the Revenue Reconciliation Act of 1990 was unwise as a tax policy matter.

The repeal of section 1275(a)(4) has made debt-for-debt exchanges involving corporate debt instruments that have the same principal amount into a "tax event," thereby introducing a "break" into what previously was a continuum of the debtor- creditor relationship between the issuer and the exchanging debtholder. As set forth in greater detail in the Report, this "break" raises a number of practical, policy and conceptual issues which, in the aggregate, caused the committee to conclude that debt-for-debt exchanges involving debt instruments that have the same principal amount should generally not be treated as "tax events."

**FORMER CHAIRS OF SECTION**

Howard O. Colgan	John W. Fager	Renato Beghe	Dale S. Collinson
Charles L. Kades	John E. Morrissey Jr.	Alfred D. Youngwood	Richard G. Cohen
Carter T. Louthan	Charles E. Heming	Gordon D. Henderson	Donald Schapiro
Samuel Brodsky	Richard H. Appert	David Sachs	Herbert L. Camp
Thomas C. Plowden-Wardlaw	Ralph O. Winger	J. Roger Mentz	William L. Burke
Edwin M. Jones	Hewitt A. Conway	Willard B. Taylor	Arthur A. Feder
Hon. Hugh R. Jones	Martin D. Ginsburg	Richard J. Hiegel	James M. Peaslee
Peter Miller	Peter L. Faber		

Accordingly, the Report recommends that section 1275(a)(4) be reinstated but that it be clarified to provide (subject to refinements described in the Report) that the issue price of a new debt instrument, if determined under section 1275(a)(4), should be the lesser of the adjusted issue price of the old debt instrument and the stated principal amount of the new debt issued. The Report further recommends that Congress consider according the same treatment to all debt- for-debt exchanges, regardless of whether or not an exchange constitutes a reorganization and whether or not the debtor is a corporation. The same considerations that suggest that section 1275(a)(4) rule provides the most satisfactory overall results for debt-for-debt exchanges of corporations pursuant to a plan of reorganization appear to apply to other debt-for-debt exchanges as well.

We understand that the Joint Committee on Taxation is now considering for the Ways & Means Committee and the Finance Committee various proposals with respect to tax legislation. At its monthly meeting this week, the Executive Committee of the Tax Section unanimously voted to renew the recommendation in the Report with respect to section 1275(a)(4) and requested that your committees be asked to consider and approve them.

Respectfully submitted,

John A. Corry  
Chair

cc: Harry L. Gutman, Esq.  
Chief of Staff  
Joint Committee on Taxation

REPORT OF AD HOC COMMITTEE  
ON PROVISIONS OF THE  
REVENUE RECONCILIATION ACT  
OF 1990 AFFECTING  
DEBT-FOR-DEBT EXCHANGES

by the Tax Section  
New York State Bar Association

This report was prepared by an ad hoc committee chaired by Yaron Z. Reich and Jodi J. Schwartz who, with David M. Rievman, were the principal authors of the report.

The report considers the treatment of debt-for-debt exchanges after the enactment of section 108(e)(11) and the repeal of section 1275(a)(4). The report concludes that the repeal of section 1275(a)(4) was a mistake for a number of practical, policy, and conceptual reasons, and recommends that it be reenacted with modifications to resolve problems that had arisen in applying the provision. The report suggests that consideration be given to expanding the scope of a new section 1275(a)(4) to cover all debt-for-debt exchanges involving a single issuer.

The report also deals with a number of important practical interpretive issues that require prompt guidance if section 1275(a)(4) is not reenacted. The most significant of these issues are (a) what modifications in the terms of a debt instrument constitute an "exchange," and (b) when is a debt instrument "traded on an established securities market" for purposes of section 1273.

The report describes the principal debt securities market systems, analyzes the policies underlying section 1273, and concludes that most securities that are listed only on the so-called yellow sheets" should not be regarded as "traded on an

established securities market" for purposes of section 1273. The report recommends a number of alternative approaches that might be considered if Congress and Treasury conclude as a policy matter that such securities should nonetheless have an issue price that is closer to fair-market value\* than would result under section 1274.

(\*Ed. note: Fair-market value is hyphenated in accordance with Tax Notes' style.]

## I. INTRODUCTION<sup>1</sup>

Section 11325(a) of the Revenue Reconciliation Act of 1990 (the "1990 Act")<sup>2</sup> amended the Internal Revenue Code of 1986

---

<sup>1</sup> This report was prepared by an ad hoc committee chartered by Yaron Z. Reich and Jodi J. Schwartz who, with David M. Rievman, were the principal authors of this report. Portions of the report were written by Shlomo Cohen, Andrew Feiner, Michael S. Kutzin, David Miller, Elliot Pisem and Lawrence Silverstein, and important assistance in its preparation was provided by Peter Termote. Helpful comments were provided by Harold Adrion, Herbert L. Camp, Peter C. Canellos, John A. Corry, Sam Dimon, Arthur A. Feder, Simon Friedman, Gordon D. Henderson, James M. Peaslee, Richard Reinhold, Matthew Rosen, Michael Schler, A visual Shachar, Mark Shifke, Williard B. Taylor and Mary Kate Wold.

It is with considerable diffidence that the Committee is sub-mining such a lengthy report, in view of the strongly held views of the New York State Bar Association Tax Section that Treasury regulations and other forms of government guidance should be shortened and simplified. However, the legislation raises a number of significant and complicated issues, it is hoped that this report will persuade Congress and the Treasury to reinstate section 1275(a)(4) with certain modifications and thereby obviate the need to address these questions.

<sup>2</sup> The Revenue Reconciliation Act of 1990 was enacted on Nov. 5, 1990, as Title XI of the Omnibus Reconciliation Act of 1990, P.L. 101-508, 104 Stat. 1388. Subject to certain grandfather" exceptions, the amendments effected by section 11325(3) of the 1990 Act generally apply to debt instruments issued after Oct. 9, 1990, in satisfaction of indebtedness.

(the "code") by adding section 108(e)(11)<sup>3</sup> and repealing section 1275(a)(4). These amendments effect significant changes in the treatment of exchanges of outstanding debt instruments for new debt instruments of the issuer ("debt-for-debt exchanges").<sup>4</sup> Section 108(e)(11) provides that for purposes of determining cancellation of indebtedness income ("COD") of a debtor from a debt-for-debt exchange, the debtor is treated as having satisfied its outstanding indebtedness with an amount of money equal to the "issue price" of the new debt instrument issued in exchange therefor. For this purpose, "issue price" is to be determined (with one technical modification) under sections 1273 and 1274, which.

---

<sup>3</sup> Except as otherwise indicated, all section references are to the code or Treasury regulations promulgated thereunder. References to regulations under sections 1271-1275 are to the proposed regulations that were published in the Federal Register. 51 F.R. 12022 (April 8, 1986), as corrected at 51 F.R. 23431 (June 27, 1986).

<sup>4</sup> The outstanding debt instruments that are exchanged for new debt instruments in a debt-for-debt exchange are referred to in this report as the "old debt instruments." The term "debt instrument" is defined broadly for purposes of sections 1271 through 1275 to mean "a bond, debenture, note, or certificate other evidence of indebtedness," other than certain annuity contracts. Section 1275(a)(1). See also prop. reg. section 1.1275-1(b) (further elaborating upon the meaning of the term). The committee recommends that the term "debt instrument" be defined for purposes of section 108(e)(11) to have the same meaning as in section 1275(a)(1).