Internal Revenue Service

Number: **200742016**
Release Date: 10/19/2007

Index Number: 1001.00-00, 1001.14-01, 163.07-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B02
PLR-148061-06

Date:
June 21, 2007

Legend

Predecessor =

P =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Debt 1 =

Debt 2 =

Debt 3 =

Debt 4 =

Debt 5 =

Debt 6 =

Debt 7 =

Debt 8 =

Debt 9 =

New Debt =

Year 1 =

Year 2 =

a =

b =

c =

d =

e =

f =

g =

Dear :

This is in response to a letter dated October 4, 2006 and subsequent correspondence, submitted on your behalf by your authorized representatives, requesting rulings that: (1) the exchange, described below, of New Debt for Debt 3 is a significant modification under section 1.1001-3 of the Income Tax Regulations; and (2) the premium, if any, paid by Sub 1 as a result of repurchasing Debt 3 will be deductible as interest expense by Sub 1 under section 1.163-7(c) of the regulations for the taxable year in which the exchange occurs.

FACTS

Predecessor acquired Sub 3 in Year 1 when Sub 3's assets were valued at $c. At the time of its acquisition, Sub 3 was engaged in the b business. When Sub 3 was acquired, P became the new holding company, and Sub 3 and Predecessor became subsidiaries of P. Sub 3 and Predecessor merged into Sub 1, which is currently a subsidiary of P. Sub 1 generates more than a percent of P's revenues. Predecessor originally issued Debt 1 and Debt 3. Sub 3 originally issued Debt 2 and Debt 4. Subsequent to its acquisition of Sub 3, Sub 1 became primarily liable for Debt 1, Debt 2, Debt 3, and Debt 4.

P acquired Sub 4 in Year 2 when Sub 4's assets were valued at $f. At the time of its acquisition, Sub 4 was engaged in the d and e businesses. After its acquisition, Sub 4 was renamed Sub 2. Sub 4 originally issued Debt 5, Debt 6, Debt 7, Debt 8, and Debt 9. Subsequent to its acquisition of Sub 4, Sub 2 became primarily liable for Debt 5, Debt 6, Debt 7, Debt 8, and Debt 9.

P serves as the common parent of an affiliated group of corporations that files a consolidated federal tax return. Sub 1 and Sub 2 are members of P's federal tax consolidated group. None of Debt 1, Debt 2, Debt 3, Debt 4, Debt 5, Debt 6, Debt 7, Debt 8, Debt 9 or New Debt is a convertible debt instrument within the meaning of section 1.1275-4(a)(4) of the regulations.

To avoid incurring additional accounting costs, Sub 1 and Sub 2 do not file separate financial statements. Instead, P files a single set of consolidated financial statements in order to satisfy SEC disclosure rules and to obtain a credit rating for a particular debt issuance. Because of Sub 1's and Sub 2's reliance on P's financial statements, P guaranteed Debt 1, Debt 2, Debt 3, Debt 4, Debt 5, Debt 6, Debt 7, Debt 8, and Debt 9 at or some time after the acquisition of Sub 3 and Sub 4.

In addition to P's guarantees described above, a covenant in Debt 3 required Sub 2 to guarantee Debt 3 if Sub 2, a material subsidiary of P, subsequently guaranteed P's credit facility. In Year 2, Sub 2 guaranteed P's credit facility, and therefore was required at that time to also guarantee Debt 3.

Proposed Transaction

Sub 2 will extend a tender offer to holders of Debt 3 to exchange their outstanding debt for (1) New Debt issued by Sub 2, and (2) a cash inducement payment. The yield and maturity of New Debt (exclusive of the cash inducement payment) will be the same as Debt 3, and P will also guarantee New Debt. Sub 2 will exchange New Debt, on a dollar-for-dollar basis, for any Debt 3 tendered, along with the cash inducement payment. If the tender offer is extended to a particular holder, that holder may elect whether to participate. Sub 1 will pay Sub 2 an amount equal to the fair market value of

any Debt 3 tendered, and any Debt 3 then tendered will be retired ("the Exchange"). Depending on market conditions, Sub 2 may also extend a similar tender offer to certain holders of Debt 1, Debt 2 and Debt 4.

The Exchange is intended to make the New Debt a "benchmark bond" that will provide a lower pricing reference for any future bond issuances by Sub 2 and to provide increased liquidity. The Exchange is also intended to reallocate the liabilities of P between Sub 1 and Sub 2 in a manner more closely reflecting those entities' respective assets and income.

P represents that Debt 3 was, and New Debt will be, regularly traded during the 60-day period ending 30 days after the issue date on an established market within the meaning of section 1.1273-2(f).

ANALYSIS

Issue 1

Section 1001 of the Internal Revenue Code provides for recognition of gain or loss on the sale or exchange of property.

Section 1.1001-1(a) of the regulations states that the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent is treated as income or as loss sustained.

Section 1.1001-3 provides rules for determining whether a modification of the terms of a debt instrument results in an exchange for purposes of section 1.1001-1(a).

Section 1.1001-3(a) establishes rules that apply to any modification of a debt instrument, regardless of the form of the modification, including an exchange of a new instrument for an existing debt instrument or a transaction that is accomplished indirectly through one or more transactions with third parties.

Section 1.1001-3(c) defines a modification as any alteration, including any deletion or addition, in whole or part, of a legal right or obligation of the issuer or a holder of a debt instrument whether the alteration is evidenced by an express agreement (oral or written), conduct of the parties, or otherwise.

If there is a modification, the modification is then tested to determine whether it is a significant modification under section 1.1001-3(e). A significant modification results in an exchange of the original debt instrument for a modified instrument that differs materially in kind or in extent within the meaning of section 1.1001-1(a).

Section 1.1001-3(e)(1) sets forth, as a general rule, that a modification is a significant modification if, based on all facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant. Paragraphs (e)(2) through (e)(6) of section 1.1001-3(e) address specific circumstances in which alterations are considered economically significant.

Subject to certain exceptions, section 1.1001-3(e)(4)(i) provides that the substitution of a new obligor on a recourse debt is a significant modification regardless of whether there is a change in payment expectations.

A modification that releases, substitutes, adds or otherwise alters a guarantee for a recourse debt is a significant modification, but only if the modification results in a change in payment expectations. See section 1.1001-3(e)(4)(iv).

In the instant case, prior to the Exchange, Sub 1 is the primary obligor with respect to Debt 3, whereas P and Sub 2 are merely secondarily liable as guarantors of the debt. As a consequence of the Exchange, Sub 1 will be released from primary liability to the extent Debt 3 is tendered. Sub 2 will agree to make payments on New Debt as they become due and payable, and will be liable as the primary obligor under the state law of g after the Exchange. P will only be secondarily liable to the holders of New Debt because of P's guarantee. The exchange of New Debt for tendered Debt 3 is an indirect modification of Debt 3 under section 1.1001-3(a). As a result of the modification, Sub 2 will replace Sub 1 as the primary obligor of the debt. Thus, the exchange of New Debt for the tendered Debt 3 will result in a significant modification under section 1.1001-3(e)(4)(i).

Issue 2

Section 163(a) provides that there shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

Section 1.163-7(c) provides that except to the extent disallowed by any other section of the Code (e.g., section 249) or this paragraph (c), if a debt instrument is repurchased by the issuer for a price in excess of its adjusted issue price (as defined in § 1.1275-1(b)), the excess (repurchase premium) is deductible as interest for the taxable year in which the repurchase occurs. If the issuer repurchases a debt instrument in a debt-for-debt exchange, the repurchase price is the issue price of the newly issued debt instrument (reduced by any unstated interest within the meaning of section 483). However, if the issue price of the newly issued debt instrument is determined under either section 1273(b)(4) or section 1274, any repurchase premium is not deductible in the year of the repurchase, but is amortized over the term of the newly issued debt instrument in the same manner as if it were original issue discount.

The Exchange will result in the repurchase of Debt 3 by Sub 1 via a debt-for-debt exchange. Accordingly, to calculate the amount of the repurchase premium, if any, as a result of the Exchange and the timing of any resulting deduction, the issue price of New Debt must be determined.

Section 1273(b) provides, in part, that (1) in the case of any issue of debt instruments (A) publicly offered, and (B) not issued for property, the issue price is the initial offering price to the public (excluding bond houses and brokers) at which price a substantial amount of such debt instruments was sold; (2) in the case of any issue of debt instruments not issued for property and not publicly offered, the issue price of each such instrument is the price paid by the first buyer of such debt instrument; (3) in the case of a debt instrument which is issued for property and which (A) is part of an issue a portion of which is traded on an established securities market, or (B) (i) is issued for stock or securities which are traded on an established securities market, or (ii) to the extent provided in regulations, is issued for property (other than stock or securities) of a kind regularly traded on an established market, the issue price of such debt instrument shall be the fair market value of such property; and (4) except in any case (A) to which section 1273(b)(1), (2), or (3) applies, or (B) to which section 1274 applies, the issue price of a debt instrument which is issued for property shall be the stated redemption price at maturity.

Section 1.1273-2(a)(1) provides that if a substantial amount of the debt instruments in an issue is issued for money, the issue price of each debt instrument in the issue is the first price at which a substantial amount of the debt instruments is sold for money. Thus, if an issue consists of a single debt instrument that is issued for money, the issue price of the debt instrument is the amount paid for the instrument.

Section 1.1273-2(b)(1) provides that if a substantial amount of the debt instruments in an issue is traded on an established market and the issue is not described in section 1.1273-2(a)(1), the issue price of each debt instrument in the issue is the fair market value of the debt instrument, determined as of the issue date.

In the instant case, New Debt will be traded on an established market and will not be issued for money. Section 483 does not affect the amount of the issue price of New Debt for purposes of section 1.163-7(c) because the debt will not originate from a transaction subject to section 483. Section 483(d) excepts from its treatment those debt instruments that are covered by section 1273(b). Under section 1.1273-2(b)(1), the issue price of New Debt will equal its fair market value.

Because the issue price of New Debt, and therefore the repurchase price of Debt 3, will be equal to the fair market value of the New Debt, identical tax consequences would result if Sub 2 first issued New Debt for cash equal to its fair market value, and then Sub 1 repurchased Debt 3 for the same amount. The fact that Sub 1 will make a direct payment to Sub 2 does not change the deductibility of the resulting premium.

Section 1.1275-1(b)(1) provides that the adjusted issue price of a debt instrument at the beginning of the first accrual period is the issue price. Thereafter, the adjusted issue price of the debt instrument is the issue price of the debt instrument, increased by the amount of original issue discount (OID) previously included in the gross income of any holder, and decreased by the amount of any payment previously made on the debt instrument other than a payment of qualified stated interest.

To the extent the issue price of New Debt exceeds the adjusted issue price of Debt 3, the difference will be treated as a repurchase premium. Because the issue price of New Debt is determined under section 1.1273-2(b) rather than sections 1273(b)(4) or 1274, the repurchase premium, if any, is deductible by Sub 1 as interest, under section 1.163-7(c), in the year that the Exchange occurs.

CONCLUSIONS

1. The exchange of tendered Debt 3 for New Debt will result in a significant modification of Debt 3 under section 1.1001-3(e)(4)(i).

2. To the extent the issue price of New Debt exceeds the adjusted issue price of Debt 3, the difference will be treated as a repurchase premium. Any resulting repurchase premium is deductible by Sub 1 as interest under section 1.163-7(c) in the year that the Exchange occurs.

CAVEATS

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code and regulations or about the tax treatment of conditions existing at the time of, or effects resulting from, the proposed transactions that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) the tax treatment of the cash inducement fee paid to the holders of Debt 3, or (ii) the application of any other provisions of the Code or regulations that may limit Sub 1's deduction of interest.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax return of P's consolidated group for the taxable year in which the Exchange occurs.

In accordance with the provisions of a power of attorney currently on file, we are sending a copy of this ruling letter to your authorized representatives.

Sincerely,

David B. Silber
David B. Silber
Senior Technician Reviewer,
Branch 6
Office of Associate Chief Counsel
(Financial Institutions &Products)