Internal Revenue Service

Number: **201105016**
Release Date: 2/4/2011

Index Number: 163.07-00, 446.27-01

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:FIP:B01
PLR-120312-10

Date:
October 19, 2010

Legend

Taxpayer =

Date 1 =

Date 2 =

Date 3 =

X =

L.P. =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

l =

m =

n =

o =

p =

q =

r =

s =

t =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6 =

Year 7 =

Year 8 =

A =

B =

C =

Dear :

This is in response to your letter dated May 11, 2010, and subsequent correspondence, requesting rulings that (1) the premium, if any, paid by Taxpayer as a result of repurchasing the Notes (as defined below) in excess of the adjusted issue price of the Notes will be deductible as interest in the taxable year in which the Notes are repurchased under section 1.163-7(c) of the Income Tax Regulations and (2) the fees paid by Taxpayer to obtain the consent of Note holders to certain amendments to the Note indentures constitute payments under the Notes that are treated under section 1.446-2(e)(1) of the regulations first as payment of accrued but unpaid interest and second as payment of principal.

FACTS

On Date 1, Taxpayer completed a business restructuring (the “Dropdown Transaction”) in which it contributed ownership interests in the entities that make up the majority of Taxpayer’s X business segments to L.P. in exchange for: (i) approximately a in cash; and (ii) an additional b limited partnership units in L.P., resulting in Taxpayer having a c percent interest in L.P. The cash consideration paid to Taxpayer was paid from the net proceeds of a private placement of L.P.’s senior unsecured notes to institutional investors. The sale of L.P.’s senior unsecured notes was not targeted to holders of the Notes. Closing the Dropdown Transaction was conditioned on, among other things, a tender offer (the “Tender Offer”) to repurchase certain of Taxpayer’s senior unsecured notes (the “Notes”) having closed or being ready to close on terms satisfactory to Taxpayer.

On Date 2, Taxpayer announced the Tender Offer and a consent solicitation to obtain the consent of the Note holders to certain amendments to the Note indentures (the “Consent Solicitation”) (described below). In the Tender Offer, Taxpayer offered to purchase up to d aggregate principal amount of the following series of fixed-rate Notes: (i) e percent notes due Year 1; (ii) f percent notes due Year 2; (iii) g percent notes due Year 3; (iv) h percent notes due Year 4; (v) i percent debentures due Year 5; (vi) j percent notes due Year 5; (vii) k percent notes due Year 6 (collectively, the “A Indenture Notes”); (viii) k percent senior notes due Year 7 (the “B Indenture Notes”); and (ix) l percent debentures due Year 8 (the “C Indenture Notes”). All of the Notes were issued on or after Date 3. None of the Notes are convertible into equity. Taxpayer represents that none of the Notes were issued with more than a de minimis amount of original issue discount, as defined in section 1273(a)(3) of the Internal Revenue Code and section 1.1273-1(d)(2).

Taxpayer offered to purchase the Notes at set prices ranging from m to n per o of principal amount, depending on the series of the Notes, plus accrued interest. Taxpayer offered to purchase p percent of the Notes tendered in the following series (the "First Priority Notes"): (i) e percent notes due Year 1; (ii) f percent notes due Year 2; (iii) g percent notes due Year 3; (iv) k percent senior notes due Year 7; and (v) l percent debentures due Year 8. Taxpayer offered to purchase Notes tendered from the other series of Notes (the "Second Priority Notes") subject to a cap (the "Second Priority Tender Cap") equal to d minus the principal amount of First Priority Notes that were accepted for purchase in the Tender Offer. The principal amount of the Second Priority Notes tendered in the Tender Offer exceeded the Second Priority Tender Cap and Taxpayer accordingly accepted for purchase only a pro rata portion of the tendered Second Priority Notes. Taxpayer paid cash of approximately q in excess of the adjusted issue prices of the Notes that it purchased in the Tender Offer.

Closing the Tender Offer and Consent Solicitation was conditioned on, among other things: (i) Taxpayer having obtained the required consents to amend the Note indentures as described below with respect to the Consent Solicitation; and (ii) the amendment of the Note indentures as described below with respect to the Consent Solicitation. In the Consent Solicitation, Taxpayer solicited the consent of holders of a majority of the A Indenture Notes, a majority of the B Indenture Notes, and a majority of the C Indenture Notes to certain amendments to the indentures for such Notes to clarify that certain covenants in the Note indentures did not apply to the Dropdown Transaction. Although Taxpayer believed that the Dropdown Transaction could have been completed without the amendment of the Note indentures, it believed it was desirable to eliminate any uncertainty in that regard by amending the Note indentures prior to the Dropdown Transaction.

A Note holder consented to the amendment of the Note indentures by tendering its Notes in the Tender Offer. Taxpayer paid each Note holder that tendered Notes in the Tender Offer a consent fee of r for each o of principal amount of Notes that were tendered, regardless of whether the Notes were purchased (due to the Second Priority Tender Cap). Taxpayer paid the consent fees of approximately s with respect to Notes that were tendered and purchased in the Tender Offer and approximately t with respect to Second Priority Notes that were tendered but not purchased (due to the Second Priority Tender Cap). Upon receiving the requisite number of holder consents, Taxpayer executed a supplemental indenture to each series of Notes, which became effective when Taxpayer completed the purchase of the tendered Notes in accordance with the Tender Offer and paid the consent fees. Taxpayer used the cash consideration it received in the Dropdown Transaction to complete the Tender Offer and Consent Solicitation on Date 1.

Taxpayer represents that the payment of the consent fees and amendments to the Note indentures do not constitute significant modifications of the Notes under section 1.1001-3 of the regulations and accordingly do not result in a deemed exchange under section 1001.

Issue 1

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) of the regulations 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 section 1.1275-1(b)), the excess (repurchase premium) is deductible as interest for the taxable year in which the repurchase occurs.

In the instant case, the Tender Offer resulted in the repurchase of certain Notes for cash in excess of the adjusted issue prices of the Notes. Therefore, the excess (repurchase premium) is deductible as interest under section 1.163-7(c) in the taxable year the Notes were repurchased in the Tender Offer. Moreover, as section 1.163-7(c) applies in the instant case, section 263 does not affect the deductibility of the repurchase premium. See sections 1.263(a)-5(j) and 1.263(a)-4(b)(4).

Issue 2

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 address specific circumstances in which alterations are considered economically significant.

Section 1.1001-3(e)(2)(ii) provides that, in general, a change in the yield of a debt instrument is a significant modification if the yield computed under section 1.1001-3(e)(2)(iii) varies from the annual yield on the unmodified instrument (determined as of the date of the modification) by more than the greater of (A) 1/4 of one percent (25 basis points); or (B) 5 percent of the annual yield of the unmodified instrument (.05 x annual yield).

Section 1.1001-3(e)(2)(iii) provides that the yield computed under section 1.1001-3(e)(2)(iii) is the annual yield of a debt instrument with (1) an issue price equal to the adjusted issue price of the unmodified instrument on the date of the modification (increased by any accrued but unpaid interest and decreased by any accrued bond issuance premium not yet taken into account, and increased or decreased, respectively, to reflect payments made to the issuer or to the holder as consideration for the modification); and (2) payments equal to the payments on the modified debt instrument from the date of the modification.

Section 1.446-2(e)(1) provides that subject to certain exceptions, each payment under a loan (other than payments of additional interest or similar charges provided with respect to amounts that are not paid when due) is treated as a payment of interest to the extent of the accrued and unpaid interest determined under sections 1.446-2(b) and (c) as of the date the payment becomes due. See also section 1.1275-2(a)(1).

In the instant case, the consent fees were paid to the Note holders as consideration for the modification of the Note indentures. Under section 1.1001-3(e)(2)(iii), such fees are treated as payments on the Notes to determine whether there is a significant change in the yield on the Notes as a result of the payment. The Taxpayer has represented that the payment of the consent fees and amendments to the Note indentures did not cause the relevant Notes to be significantly modified. Nonetheless, section 1.1001-3(e)(2)(iii) indicates that payments made as consideration for modifying a debt instrument should be treated as payments under such debt instrument. See also section 1.1001-3(g), Example 1. As such, section 1.446-2(e)(1) applies to determine how the consent fee is treated for federal income tax purposes. Accordingly, the consent fees in the instant case are treated first as payments of accrued interest, to the extent of any accrued and unpaid interest, and second as payments of principal on the Notes. To the extent the consent fee is treated as a payment of principal, such amount will decrease the adjusted issue price of the relevant Note. If the Taxpayer repurchases a Note for an amount in excess of the adjusted issue price of the Note on the repurchase date, such excess will be repurchase premium and will be deductible as interest in the taxable year such Note is repurchased under section 1.163-7(c). Moreover, as section 1.446-2(e)(1) applies in the instant case, section 263 does not affect the treatment of the consent payment. See sections 1.263(a)-5(j) and 1.263(a)-4(b)(4).

Conclusions

1. The amount paid by Taxpayer to the Note holders in the Tender Offer to repurchase Notes in excess of the adjusted issue prices of the Notes constitutes repurchase premium that is deductible as interest in the taxable year the relevant Notes were repurchased under section 1.163-7(c).

2. The consent fees constitute payments under the Notes and, pursuant to section 1.446-2(e)(1), such payments first reduce the amount of any accrued and unpaid interest on the Notes on which they are paid and then are treated as a payment of principal on such Notes. To the extent the consent fee is treated as a payment of principal, such amount will decrease the adjusted issue price of the relevant Note. If the Taxpayer repurchases such Note for an amount in excess of the adjusted issue price of the Note on the repurchase date, such excess will be repurchase premium and will be deductible as interest in the taxable year such Note is repurchased under section 1.163-7(c).

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.

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. Taxpayer should attach a copy of this ruling to each tax return to which it applies.

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 representative.

Sincerely,

Diana Imholtz____________
Diana Imholtz
Branch Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions & Products)