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Legend

W =

X =

Y =

Z =

Note 1 =

Note 2 =

Bank 1 =

Bank 2 =

This is in response to a letter dated June 19, 1998, and subsequent correspondence, requesting a ruling that W's assumption of Note 1 and Note 2, as well as the release of Y from all obligations thereunder, is not a significant modification under section 1.1001-3 of the Income Tax Regulations and, therefore, will not be treated as a taxable exchange under section 1001 of the Code.

FACTS

W is the common parent of an affiliated group of corporations that file a consolidated tax return. Y is the primary issuer of term debt for W and its affiliates. Y's assets consist of deposits with W and its affiliates, a small amount of real property and stock in Z, a wholly owned finance subsidiary of Y. Y is wholly owned by X, a finance and holding company that is wholly owned by W. X, Y and Z are all members of W's federal tax consolidated group.

As noted above, Y is the primary issuer of term debt for W and its affiliates. W unconditionally guarantees all of Y's debt instruments. Under the guarantees, W waives diligence, presentment, demand of payment, filing of claims with a court in the event of merger or bankruptcy of Y, and any right to require a proceeding first against Y. The guarantees can only be discharged by payment in full for both notes.

Due to W's credit, major rating companies rate Y's debt instruments at the highest possible credit rating. Pursuant to SEC disclosure rules that address filings involving securities guaranteed by a parent, all financial information provided in the prospectus for a debt instrument issued by Y relates to W. Accordingly, no Y financial statements are included in the applicable offering documents or filings for Y's debt instruments.

When Y issues debt, Y deposits the proceeds into its account at Bank 1. Y then lends the funds to W and its affiliates. At the end of each day, any funds left in Y's bank account are transferred automatically into W's account at Bank 1. W then transfers the balance of this account into its account at Bank 2 and invests all of its surplus cash in bank time deposits or commercial paper. If there is a deficit in Y's bank account, W automatically transfers funds from its account at Bank 1 into Y's account to bring Y's balance to $0.

Currently, Y has four debt issuances on its balance sheet, including Note 1 and Note 2. Note 1 and Note 2 contain restrictions on the sale of all or substantially all of Y's assets. Note 1 and Note 2 provide that Y can not sell or convey all or substantially all of its assets to any other corporation unless the transferee corporation shall expressly assume the due and punctual payment of the notes. The terms of Note 1 and Note 2 also permit W, as guarantor, to assume liability thereunder.

W intends to restructure X, Y and Z to simplify the ownership chain and reduce the administrative burdens associated with the current structure. Accordingly, Z will merge with Y and a portion of Y's assets will be distributed to W. X will then merge with Y.

The restructuring plan reduces Y's portfolio and shrinks the size of its balance sheet. The restrictive covenants contained in Note 1 and Note 2 hamper this effort because the amount of assets which can be transferred out of Y is limited to something less than substantially all. Therefore, before implementing the restructuring plan, W proposes to assume Note 1 and Note 2 in accordance with the terms of the notes. Y will also be released from all of its obligations under both notes. W's assumption of the notes will provide greater flexibility in transferring assets

out of Y and will permit W to proceed with its proposed restructuring. Except for W's assumption and corresponding release of Y from its obligations under Note 1 and Note 2, no other changes to the terms of the notes are proposed.

ANALYSIS

Section 1001 of the 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). An alteration of the terms of a debt instrument is first tested to determine whether the alteration is a modification. If there is a modification, the modification is then tested to determine whether it is a significant modification. 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(c)(2)(i) provides that an alteration that results in the substitution of a new obligor, or the addition or deletion of a co-obligor, is a modification even if the alteration occurs by operation of the terms of the debt instrument. Accordingly, W's assumption of the notes and corresponding release of Y from its obligations thereunder is a modification.

Whether the modification of these notes is significant is determined under the rules of section 1.1001-3(e). Subject to the exceptions set forth in paragraphs (e)(2) through (e)(6), a significant modification occurs when, 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. In the instant case, W's liability under the terms of the guarantee for Note 1 and Note 2 is essentially that of a co-obligor. Therefore, the release of Y from its obligations under the notes falls within section 1.1001-3(e)(4)(iii). This paragraph provides that the addition or deletion of a co-obligor on a debt instrument is a significant modification if the addition or deletion of the co-obligor results in a change in payment expectations.

The notes of Y are unconditionally guaranteed by W and assumable by W. Y's assets consist of deposits with W and its affiliates, a small amount of real property, and stock in Z. Y

serves only as a finance vehicle for W and its affiliates. Since W remains liable on the notes before and after the modification, the deletion of Y as a co-obligor does not result in a change in payment expectations. Thus, the assumption of the notes by W without any other change in terms does not constitute a significant modification under section 1.1001-3(e)(4)(iii).

CONCLUSION

We conclude that W's assumption of Note 1 and Note 2, as well as the release of Y from all obligations thereunder, is not a significant modification under section 1.1001-3 of the regulations and, therefore, will not be treated as a taxable exchange under section 1001 of the Code.

Except as specifically ruled upon above, no opinion is expressed or implied as to the federal tax consequences of the transaction described above under any other provision of the Internal Revenue Code.

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.

Sincerely yours,

Assistant Chief Counsel
(Financial Institutions & Products)

By: ______________________________
William E. Coppersmith
Chief, Branch 2

Enclosure:
Copy of this letter
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