



Dear \_\_\_\_\_ :

This letter responds to your letter dated May 1, 2015, requesting a ruling on behalf of Taxpayer regarding the U.S. federal income tax treatment of proposed changes to certain debt instruments issued by Taxpayer. Specifically, you have requested the following rulings:

(1) The payment of the Consent Payment (as defined below) to one or more Noteholders (as defined below) is a modification of the terms of the Notes (as defined below) that must be tested for significance under Treasury Regulation section 1.1001-3(e).

(2) To determine whether the Consent Payment results in a significant modification within the meaning of the general facts and circumstances test of section 1.1001-3(e)(1), Taxpayer should compare the “go-forward yield” to the “original yield” of each outstanding Note. If the excess of the “go-forward yield” over the “original yield” is not more than the greater of (i) 0.25 percent or (ii) 5 percent of the “original yield,” the modification does not result in a significant modification within the meaning of section 1.1001-3(e)(1).

(3) If the Consent Payment does not result in a significant modification, the payment is a positive adjustment within the meaning of section 1.1275-4(b)(6) equal to the amount of such payment.

(4) The combination of the Consent Payment and a modification to the Notes that would not alone result in a significant modification of the Notes under section 1.1001-3(e)(6) is not a significant modification under section 1.1001-3(e)(1).

**Facts:**

Taxpayer is a publicly traded and widely held corporation and the parent of an affiliated group of corporations for U.S. federal income tax purposes. Taxpayer operates and owns interests in a broad range of subsidiaries and companies engaged in the video and online commerce industries. Taxpayer has a series of publicly traded common stock.

Subsidiary, a State limited liability company, is wholly-owned by Taxpayer and is an entity disregarded as separate from Taxpayer under section 301.7701-3. Subsidiary has b series of publicly traded exchangeable debentures, each of which is a contingent payment debt instrument as defined in section 1.1275-4 (each, a “Note”, and, collectively, the “Notes”). The Notes are issued pursuant to an indenture (the “Indenture”). Each outstanding Note is subject to the noncontingent bond method of section 1.1275-4(b). Taxpayer represents that interest expense with respect to each of Taxpayer’s outstanding Notes is being accrued by reference to a comparable yield and

projected payment schedule pursuant to section 1.1275-4(b). The comparable yield on the Notes ranges from c to d percent.

Taxpayer intends to effect a spin-off transaction pursuant to which (i) certain businesses and other assets currently owned directly or indirectly by Subsidiary will be contributed to a newly formed corporation (the "Spinco"), (ii) Subsidiary will distribute all of the stock of Spinco to Taxpayer, and (iii) Taxpayer will distribute all of the stock of Spinco to the holders of certain classes of its common stock in redemption of such stock (collectively, the "Current Spinoff"). The Current Spinoff is intended to be tax-free under sections 355 and 368(a)(1)(D) of the Internal Revenue Code.

Prior to an earlier spinoff of assets to Taxpayer's shareholders ("Prior Spinoff 1"), a dispute arose between the holders of the Notes (the "Noteholders") and Taxpayer regarding whether Prior Spinoff 1 would violate a provision in the Indenture that prohibits Taxpayer from transferring substantially all of its assets unless, among other things, the entity to which the assets are transferred assumes Taxpayer's obligations under the Indenture (the "Successor Provision"). This dispute over the Successor Provision resulted in litigation between the Noteholders and Taxpayer in Court 1 and Court 2. Taxpayer prevailed in the litigation and Prior Spinoff 1 was consummated; however, this process delayed Prior Spinoff 1 and was costly to Taxpayer who was also required to pay the Noteholders' attorneys' fees.

In light of the previous litigation, Taxpayer believes that in connection with the Current Spinoff a similar dispute could arise between the Noteholders and Taxpayer. Taxpayer believes that any such litigation would be without merit and has represented that it would oppose such a challenge. In order to avoid the cost and distraction that could unduly delay the consummation of the Current Spinoff, Taxpayer would like the ability to negotiate with the Noteholders to receive the explicit consent of the requisite number of Noteholders to a modification of the Successor Provision under the Indenture that will permit the Current Spinoff to proceed without the threat of Noteholder litigation by providing a one-time cash payment to consenting Noteholders (the "Consent Payment"). The amount of the Consent Payment would be negotiated between Taxpayer and representatives of the Noteholders. The Consent Payment would not otherwise affect the amounts that Noteholders are entitled to receive under the terms of the Notes.

Taxpayer completed a similar spinoff of Company in Month 1 of Year 1 ("Prior Spinoff 2"). In anticipation of Prior Spinoff 2, Taxpayer obtained a private letter ruling similar to the one requested herein. The Noteholders did not challenge Prior Spinoff 2 and, therefore, it was unnecessary to make a consent payment in connection with that transaction. With respect to the Current Spinoff, however, Taxpayer may need to make a consent payment.

Taxpayer represents that it understands, based upon conversations with Advisor, that the Successor Provision is a standard covenant found in the vast majority of investment grade and high yield deals distributed by Advisor. Taxpayer also represents that it does not expect that the Current Spinoff will result in a change in payment expectations within the meaning of Section 1.1001-3(e)(4)(vi) with respect to the Notes. Further, Taxpayer represents that there have been no prior modifications (as defined in section 1.1001-3(c)) to any of the Notes.

### **Law and Analysis:**

Section 1001 provides rules for the computation and recognition of gain or loss from a sale or other disposition of property. For purposes of section 1001, section 1.1001-1(a) generally provides that gain or loss is realized upon an exchange of property for other property differing materially either in kind or in extent. In *Cottage Savings Ass'n v. Comm'r*, 499 U.S. 554, 566 (1991) [1991-2 CB 34, 38], the Court concluded that under section “1001(a), an exchange of property gives rise to a realization event so long as the exchanged properties are ‘materially different’--that is, so long as they embody legally distinct entitlements.”

Section 1.1001-3(a) states that 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 applies to any modification of a debt instrument, regardless of the form of the modification. For example, section 1.1001-3 applies to an exchange of a new instrument for an existing debt instrument, to an amendment of an existing debt instrument, or to a modification of a debt instrument that the issuer and holder accomplish indirectly through one or more transactions with third parties.

Section 1.1001-3(c)(1)(i) defines a modification as any alteration, including any deletion or addition, in whole or in 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.

Section 1.1001-3(b) states that for purposes of section 1.1001-1(a), a significant modification of a debt instrument, within the meaning of section 1.1001-3, results in an exchange of the original debt instrument for a modified instrument that differs materially either in kind or in extent. A modification that is not a significant modification is not an exchange for purposes 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. In making a determination under section 1.1001-3(e)(1), all modifications to the debt instrument (other than modifications subject to paragraphs (e)(2) through (e)(6)

of section 1.1001-3) are considered collectively, so that a series of such modifications may be significant when considered together although each modification, if considered alone, would not be significant. Paragraphs (e)(2) through (e)(6) of section 1.1001-3 address specific circumstances in which modifications are not 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). However, section 1.1001-3(e)(2)(i) states that such change in yield rule only applies to debt instruments that provide for only fixed payments, debt instruments with alternative payment schedules subject to section 1.1272-1(c), debt instruments that provide for a fixed yield subject to section 1.1272-1(d) (such as certain demand loans), and variable rate debt instruments. Whether a change in the yield of other debt instruments (for example, a contingent payment debt instrument) is a significant modification is determined under the general facts and circumstances rule of section 1.1001-3(e)(1).

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 1.1001-3(e)(6) states that a modification that adds, deletes, or alters customary accounting or financial covenants is not a significant modification.

Section 1.1001-3(f)(4) states that modifications of different terms of a debt instrument, none of which separately would be a significant modification under paragraphs (e)(2) through (6) of section 1.1001-3, do not collectively constitute a significant modification.

Section 1.1275-4(b)(1) states that the noncontingent bond method applies to contingent payment debt instruments that have an issue price determined under section 1.1273-2. Section 1.1275-4(b)(2) states that generally, under the noncontingent bond method, interest on a debt instrument must be taken into account whether or not the amount of any payment is fixed or determinable in the taxable year. The amount of interest that is taken into account for each accrual period is determined by constructing a projected payment schedule for the debt instrument and applying rules similar to

those for accruing OID on a noncontingent debt instrument. If the actual amount of a contingent payment is not equal to the projected amount, appropriate adjustments are made to reflect the difference.

Under section 1.1275-4(b)(6)(i), if the amount of a contingent payment is more than the projected amount of the contingent payment, the difference is a positive adjustment on the date of the payment. If the amount of a contingent payment is less than the projected amount of the contingent payment, the difference is a negative adjustment on the date of the payment (or on the scheduled date of the payment if the amount of the payment is zero).

In the instant case, the Consent Payment will result in the Noteholders receiving money to which they had not been previously entitled under the terms of the Indenture. Thus, the Consent Payment will be an alteration of the legal rights or obligations of the holders and issuer of the Notes, which is a modification under section 1.1001-3(c)(1)(i).

Because the Consent Payment will result in the holders of the Notes receiving more money than they otherwise would have under the terms of the Note, it will change the yield on the Notes. For debt instruments that are not contingent payment debt instruments, whether a change in yield results in a significant modification of a debt instrument is normally tested under the change in yield rule of section 1.1001-3(e)(2). However, because the Notes are contingent payment debt instruments, whether the Consent Payment results in a significant modification is instead tested under the general facts and circumstances test of section 1.1001-3(e)(1). Here, because the noncontingent bond method of accounting provides the Notes with interest that accrues by reference to a comparable yield and a projected payment schedule pursuant to section 1.1275-4(b), and the Consent Payment will result in a one-time payment to the holders of the Notes and will not otherwise alter the amounts that the holders of the Notes will receive, it is appropriate to apply a test similar to the change in yield test in section 1.1001-3(e)(2). Therefore, to determine whether the Consent Payment results in a significant modification within the meaning of the general facts and circumstances test of section 1.1001-3(e)(1), Taxpayer should compare the “go-forward yield” to the “original yield” of each outstanding Note. The “go-forward yield” is the yield of a hypothetical debt instrument having (i) an issue date on the date the Notes are modified; (ii) an issue price equal to the adjusted issue price of the applicable Note as of that date, reduced by the amount of the Consent Payment; and (iii) a projected payment schedule consisting of the remaining payments on the applicable Note’s original projected payment schedule. The “original yield” is the comparable yield of each Note determined under section 1.1275-4(b)(4) as of the issue date of each Note. If the excess of the “go-forward yield” over the “original yield” is not more than the greater of (i) 0.25 percent or (ii) 5 percent of the “original yield,” the modification will not result in a significant modification within the meaning of section 1.1001-3(e)(1).

Under the noncontingent bond method in section 1.1275-4(b), payments received by a holder of a contingent payment debt instrument are generally compared against the projected payment schedule. To the extent payments exceed the amounts that had been projected, such payments are treated as a positive adjustment. To the extent payments are less than the amounts that had been projected, such payments are treated as a negative adjustment. Because the Consent Payment was not originally reflected on the projected payment schedule, it is akin to an amount received in respect of a projected payment of zero. Thus, it is a payment in excess of the projected payment and it is appropriate to treat it as a positive adjustment under section 1.1275-4(b)(6)(i) if the Consent Payment is not a significant modification.

To the extent the Consent Payment does not result in a significant modification under the test described above and any other modification made to the terms of the Notes does not individually result in a significant modification under section 1.1001-3(e)(6), such modifications will not collectively result in a significant modification of the Notes under section 1.1001-3(e)(1).

### **Conclusion:**

We hereby rule as follows:

(1) The payment of the Consent Payment to one or more Noteholders is a modification of the terms of the Notes that must be tested for significance under section 1.1001-3(e)(1).

(2) To determine whether the Consent Payment results in a significant modification within the meaning of the general facts and circumstances test of section 1.1001-3(e)(1), Taxpayer should compare the “go-forward yield” to the “original yield” of each outstanding Note. If the excess of the “go-forward yield” over the “original yield” is not more than the greater of (i) 0.25 percent or (ii) 5 percent of the “original yield,” the modification does not result in a significant modification within the meaning of section 1.1001-3(e)(1).

(3) If the Consent Payment does not result in a significant modification, the payment is a positive adjustment within the meaning of section 1.1275-4(b)(6) equal to the amount of such payment.

(4) The combination of a Consent Payment that does not result in a significant modification and a modification that is not a significant modification of the Notes under section 1.1001-3(e)(6) will not be considered a significant modification under section 1.1001-3(e)(1).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or

referenced in this letter. Specifically, no opinion is expressed regarding the spinoff transaction. Additionally, we express no opinion on whether the modification, waiver, or amendment of the Successor Provision is a significant modification of the Notes under section 1.1001-3(e)(6).

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the provisions of a Power of Attorney on file, we are sending a copy of this ruling letter to your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Andrea M. Hoffenson  
Branch Chief, Branch 2  
Office of Associate Chief Counsel  
(Financial Institutions & Products)

cc: