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Date:
November 10, 2016

LEGEND

Parent =
Sub1 =
Sub2 =
State1 =
State2 =
Old Bond 1 =
Old Bond 2 =
Old Bond 3 =
Old Bond 4 =
Old Bond 5 =
Old Bond 6 =
Old Bond 7 =
New Bond 1 =
New Bond 2 =
New Bond 3 =
New Bond 4 =
New Bond 5 =
New Bond 6 =
New Bond 7 =
Date 1 =
a% =
b% =
c% =
d% =
e% =
f% =
g% =

Dear _____ :

This letter responds to your letter of May 12, 2016, and subsequent correspondence requesting the following rulings:

(1) Parent must account for any bond issuance premium arising from the issuance of its bonds in exchange for certain tendered bonds of which Sub2 was the obligor in accordance with section 1.163-13 of the Income Tax Regulations; and

(2) Sub2 is entitled to a deduction, pursuant to section 1.163-7(c), for any repurchase premium realized upon the deemed satisfaction of certain tendered bonds, in the taxable year in which the deemed satisfaction occurred.

FACTS

Parent is a publicly traded corporation organized under the laws of State1. Sub1, a State2 corporation, is a wholly owned subsidiary of Parent. Sub2, a State1 corporation, is a wholly owned subsidiary of Sub1. Parent, Sub1, and Sub2 are members of an affiliated group of corporations, which files a consolidated federal income tax return. Parent is the common parent of the affiliated group.

Sub2 was the obligor of seven tranches of fixed-rate, senior, unsecured bonds: Old Bond 1, Old Bond 2, Old Bond 3, Old Bond 4, Old Bond 5, Old Bond 6, and Old Bond 7 (“Old Tranches”). The bonds in Old Bond 7 had been integrated previously with three interest rate swaps under § 1.1275-6. Parent and Sub2 represent that Old Bond 7 and the swaps constituted a qualifying debt instrument within the meaning of section 1.1275-6(b)(1) and section 1.1275-6 hedges within the meaning of section 1.1275-6(b)(2), respectively. They further represent that the requirements of section 1.1275-6(c)(1)(i) – (vii) were satisfied in a timely manner. On Date 1, Parent issued bonds in seven corresponding tranches: New Bond 1, New Bond 2, New Bond 3, New Bond 4, New Bond 5, New Bond 6, and New Bond 7 (“New Tranches”), none of which belongs to an issue for which a substantial amount of the bonds was issued for money within the meaning of section 1.1273-2(a)(1).

Parent offered to exchange a newly issued bond from New Bond 1 and a consent fee for each bond tendered from Old Bond 1. Parent made similar offers with respect to New Bond 2 and Old Bond 2, with respect to New Bond 3 and Old Bond 3, with respect to New Bond 4 and Old Bond 4, with respect to New Bond 5 and Old Bond 5, with respect to New Bond 6 and Old Bond 6, and with respect to New Bond 7 and Old Bond 7. These seven offers will be referred to collectively as the “Tender Offer”.

Pursuant to the Tender Offer, holders tendered a% of the bonds in Old Bond 1, b% of the bonds in Old Bond 2, c% of the bonds in Old Bond 3, d% of the bonds in Old Bond 4, e% of the bonds in Old Bond 5, f% of the bonds in Old Bond 6, and g% of the bonds in Old Bond 7. On Date 1, Parent exchanged newly issued bonds from the New Tranches and consent fees for the tendered bonds (collectively, the “Exchange”).

Parent and Sub2 represent that the tendered bonds were not intercompany obligations, within the meaning of section 1.1502-13(g)(2)(ii), before the Exchange.

The aggregate stated principal amount of each of the seven New Tranches of bonds issued by Parent (i.e., New Bond 1, New Bond 2, New Bond 3, New Bond 4, New Bond 5, New Bond 6, and New Bond 7) was equal to the aggregate stated principal amount of the bonds tendered from the seven corresponding Old Tranches of bonds (i.e., Old Bond 1, Old Bond 2, Old Bond 3, Old Bond 4, Old Bond 5, Old Bond 6, and Old Bond 7).

Parent represents that the newly issued bonds in each of the New Tranches were traded on an established market within the meaning of section 1.1273-2(f). Parent further represents that the newly issued bonds in each of the New Tranches provided for stated interest, which met the definition of qualified stated interest (“QSI”) in section 1.1273-1(c).

Sub2 retired each of the tendered bonds from the Old Tranches in exchange for an intercompany payable to Parent. Parent and Sub2 recorded the intercompany receivable and intercompany payable in their respective books and records for an amount equal to the aggregate stated principal amount of the tendered bonds. Sub2 did not issue notes to Parent or otherwise document the intercompany payable. The recorded amount did not bear interest and was being paid over time by Sub2 to Parent in cash. Sub2 remained the obligor on the bonds from the Old Tranches that were not tendered.

Ruling request (1)

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

Subject to certain exceptions not relevant here, section 1.163-13 limits the amount of the issuer’s interest deduction otherwise allowable under section 163(a) for debt instruments issued with bond issuance premium. See section 1.163-13(a). In general, an issuer determines its interest deductions by offsetting the interest allocable to an accrual period with the bond issuance premium allocable to that period. See section 1.163-13(a). Bond issuance premium is the excess, if any, of the issue price of a debt instrument over its stated redemption price at maturity. See section 1.163-13(c)

Under section 1.163-13(d)(1), an issuer amortizes bond issuance premium by offsetting the QSI allocable to an accrual period with the bond issuance premium allocable to the accrual period. This offset occurs when the issuer takes the QSI into account under its regular method of accounting. Section 1.163-13(d)(3) provides rules to determine the amount of bond issuance premium allocable to an accrual period. Section 1.163-13(d)(4) provides rules for the case that the bond issuance premium allocable to an accrual period exceeds the QSI allocable to the accrual period.

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.

Section 1.1273-2(f) provides rules for determining whether property (including a debt instrument described in section 1.1273-2(b)(1)) is traded on an established market.

The stated redemption price at maturity of a debt instrument is the sum of all payments provided by the debt instrument other than QSI payments. See section 1.1273-1(b).

QSI generally is stated interest that is unconditionally payable in cash at least annually at a single fixed rate. See section 1.1273-1(c)(1).

Based on the representations and facts submitted, the newly issued bonds in each of the New Tranches were separate issues. The bonds were traded on an established market and were not issued for money. Accordingly, the issue price of each newly issued bond was determined under section 1.1273-2(b)(1) and was equal to the bond's fair market value on Date 1. See section 1.1273-2(b)(1); section 1.1273-2(f). Moreover, because the stated interest for each newly issued bond constituted QSI, the stated redemption at maturity of each bond was its stated principal amount.

For each newly issued bond in each of the New Tranches, the excess, if any, of the bond's issue price (its fair market value) over the bond's stated redemption price at maturity (its stated principal amount) constituted bond issuance premium, for which Parent must account in accordance with section 1.163-13(d). Thus, the interest deduction with respect to each newly issued bond must be determined by offsetting the

QSI allocable to an accrual period with the bond issuance premium allocable to that period.

Ruling request (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, in part, that, except to the extent disallowed by any other section of the Code (e.g., section 249) or section 1.163-7(c), if a debt instrument is repurchased by the issuer for a price in excess of its adjusted issue price, 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 ("OID").

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 OID previously includible 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 QSI.

Section 1.1502-13(g) provides rules for taking into account items of income, gain, deduction, and loss of members of a consolidated group from intercompany obligations.

Section 1.1502-13(g)(2)(i) defines a "debt of a member" as any obligation of the member constituting indebtedness under general principles of Federal income tax law (for example, under non-statutory authorities, or under section 108, section 163, or section 1.1275-1(d)), but not an executory obligation to purchase or provide goods or services.

Section 1.1502-13(g)(2)(ii) defines an "intercompany obligation" as an obligation between members, but only for the period during which both parties are members.

Section 1.1502-13(g)(5) provides rules that apply if an obligation that is not an intercompany obligation becomes an intercompany obligation.

Section 1.1502-13(g)(5)(ii)(A) provides that, if the intercompany obligation is debt of a member, then the debt is treated for all Federal income tax purposes, immediately after it becomes an intercompany obligation, as having been satisfied by the debtor for cash in an amount determined under the principles of section 1.108-2(f), and then as having been reissued as a new obligation (with a new holding period but otherwise identical terms) for the same amount of cash. If the intercompany obligation is a security of a member, similar principles apply (with appropriate adjustments) to treat the security, immediately after it becomes an intercompany obligation, as satisfied and reissued by the debtor for cash in an amount equal to its fair market value.

Generally, under section 1.108-2(f)(i), except as otherwise provided in section 1.108-2(f), the amount of discharge of indebtedness income realized under section 1.108-2(a) is measured by reference to the adjusted basis of the related holder (or of the holder that becomes related to the debtor) in the indebtedness on the acquisition date if the holder acquired the indebtedness by purchase on or less than six months before the acquisition date.

Under section 1.1502-13(g)(5)(ii)(B), the deemed satisfaction and deemed reissuance are treated as transactions separate and apart from the transaction in which the debt becomes an intercompany obligation, and the tax consequences of the transaction in which the debt becomes an intercompany obligation must be determined before the deemed satisfaction and reissuance occurs.

Section 1.1502-13(g)(6)(iii) provides that if an obligation to which section 1.1502-13(g)(5) applies is acquired in exchange for the issuance of an obligation to a nonmember and the issue price of this newly issued obligation is not determined by reference to its fair market value (for example, the issue price is determined under section 1273(b)(4) or 1274(a) or any other provision of applicable law), then, under the principles of section 1.163-7(c), any repurchase premium from the deemed satisfaction of the intercompany obligation under section 1.1502-13(g)(5)(ii) will be amortized by the debtor over the term of the obligation issued to the nonmember in the same manner as if it were OID and the obligation to the nonmember had been issued directly by the debtor.

Section 1.1275-6(d)(2) sets forth rules for legging out of an integrated transaction. Subject to certain exceptions not relevant here, section 1.1275-6(d)(2)(i)(A) provides, in pertinent part, that if a taxpayer has integrated a qualifying debt instrument and a section 1.1275-6 hedge under section 1.1275-6(c)(1), "legging out" means that prior to maturity of the synthetic debt instrument, the taxpayer disposes of or otherwise terminates all or a part of the qualifying debt instrument or the section 1.1275-6 hedge.

If the issuer of a qualifying debt instrument that has been integrated with a § 1.1275-6 hedge legs out of the integrated transaction, for example, by repurchasing the qualifying debt instrument, immediately before the issuer legs out, the issuer is

treated as repurchasing or otherwise terminating the synthetic debt instrument for its fair market value and, except as provided in section 1.1275-6(d)(2)(ii)(D), any income, deduction, gain, or loss is realized and recognized at that time. See section 1.1275-6(d)(2)(ii)(B).

The acquisition by Parent of the tendered bonds from the Old Tranches on Date 1 caused the tendered bonds to become intercompany obligations. See section 1.1502-13(g)(2). Immediately after the tendered bonds became intercompany obligations, the tendered bonds were deemed to be satisfied in cash for an amount equal to Parent's adjusted basis therein under the principles of section 1.108-2(f). See section 1.1502-13(g)(5)(ii).

The issue price of each newly issued bond from the New Tranches was determined under section 1273(b)(3) and was equal to its respective fair market value. See discussion under Ruling request (1), infra; section 1.1273-2(b)(1); section 1.1273-2(f).

As a result of the deemed satisfaction of the tendered bonds from the Old Tranches other than Old Bond 7, Sub2 realized repurchase premium to the extent of any excess of Parent's adjusted basis in each tendered bond over the respective bond's adjusted issue price.

Because the issue price of each newly issued bond was not determined under section 1273(b)(4) or section 1274, the special rule in section 1.1502-13(g)(6)(iii), requiring repurchase premium to be amortized over the term of the bond as if it were OID, does not apply. But cf. section 1.1502-13(g)(7), ex. 10 (iii). Accordingly, the realized repurchase premium, if any, is deductible by Sub2, as interest under section 1.163-7(c) in determining the consolidated taxable income in the taxable year in which the deemed satisfaction occurred.

For the tendered bonds from Old Bond 7, the deemed satisfaction under section 1.1502-13(g)(5)(ii)(A) is a legging out under section 1.1275-6(d)(2), which causes a deemed repurchase under section 1.1275-6(d)(2)(ii)(B). Any income or deduction realized on the deemed repurchase is recognized in lieu of recognition of any income or deduction on the deemed satisfaction.

Caveats

No opinion is expressed about the tax treatment of the 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 transactions that are not specifically covered by the above rulings. Specifically, no opinion is expressed as to whether the intercompany payables constituted bone fide indebtedness. Further, no opinion is expressed as to whether the retirement of each tendered bond in exchange for an

intercompany payable constituted a triggering transaction within the meaning of section 1.1502-13(g)(3)(i)(A) or qualified for the exception, pertaining to the routine modification of an intercompany obligation, within the meaning of section 1.1502-13(g)(3)(i)(B), (6). Finally, no opinion is expressed as to whether each bond issued by Parent qualified as publicly traded within meaning of sections 1.1273-2(b)(1) and 1.1273-2(f).

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Parent 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 copies of this ruling letter to your authorized representatives.

Sincerely,

Charles W. Culmer
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Financial Institutions & Products)

cc: