
26 CFR 601.601: Rules and regulations.
(Also Part I, sections 1001; 1.1001-3, 1.1275-2.)

Rev. Proc. 99-18

SECTION 1. PURPOSE

This revenue procedure provides for an election that will facilitate the substitution of some or all of the debt instruments from two or more outstanding issues of debt with debt instruments from a new issue. Under the election, taxpayers can treat a substitution of debt instruments, in certain circumstances, as a realization event for federal income tax purposes even though it does not result in a significant modification under § 1.1001-3 of the Income Tax Regulations (and, therefore, is not an exchange for purposes of § 1.1001-1(a)). Under section 4 of this revenue procedure, taxpayers do not recognize any realized gain or loss on the date of the substitution. Instead, the gain or loss generally is taken into account as income or deductions over the term of the new debt instruments.

SECTION 2. BACKGROUND

.01 Under § 1.1001-1(a), gain or loss is realized from the exchange of property for other property differing materially either in kind or in extent.

.02 Section 1.1001-3 provides rules to determine whether a modification of the

terms of a debt instrument results in an exchange of the original debt instrument for a modified instrument that differs materially either in kind or in extent. Under § 1.1001-3, a modification of a debt instrument results in an exchange for purposes of § 1.1001-1(a) if the modification is significant. A modification that is not significant does not result in an exchange for purposes of § 1.1001-1(a). Section 1.1001-3 applies to any modification of a debt instrument, regardless of the form of the modification (including an exchange of a new instrument for an existing instrument).

.03 Under § 1.1001-3(c), a modification means 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.

.04 In general, a modification of a debt instrument is a significant modification under § 1.1001-3 only if, based on all the facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant. Section 1.1001-3(e) provides rules to determine whether certain modifications, such as a change in yield or the timing of payments, constitute significant modifications.

.05 If the terms of a debt instrument are modified to defer one or more payments and the modification does not result in an exchange under § 1.1001-3, § 1.1275-2(j) provides rules to account for the modified debt instrument. Under § 1.1275-2(j), solely for purposes of §§ 1272 and 1273 of the Internal Revenue Code, the debt instrument is treated as retired and then reissued on the date of the modification for an amount equal to the instrument's adjusted issue price on that date. As a result, the debt instrument is retested for original issue discount based on the instrument's adjusted issue price and the remaining payments, as modified, to be made on the instrument. If the debt instrument has original issue discount as a result of the modification, both the issuer and the holder account for the original

issue discount over the remaining term of the instrument. See §§ 163(e) and 1272.

.06 An issuer may want to refinance and consolidate debt instruments (“old debt”) from two or more outstanding issues of debt into debt instruments (“new debt”) from a single new issue. In general, if the terms of the new debt are not materially different from the terms of the old debt, substituting the new debt for the old debt does not result in a significant modification of the old debt under § 1.1001-3. Therefore, the substitution of the new debt for the old debt in the consolidation is not a realization event for federal income tax purposes. However, under § 1.1275-2(j), some or all of the new debt may have original issue discount in varying amounts, depending upon the terms of the old debt for which the new debt was substituted. As a result, the new debt may not be fungible.

SECTION 3. SCOPE

This revenue procedure applies to the substitution of new debt for old debt if all of the following conditions are satisfied:

.01 Debt instruments from a single new issue are being substituted for debt instruments from two or more old issues of debt. (It is not necessary, however, for any single holder of the old debt to have held debt instruments from more than one of the old issues.)

.02 The substitution does not result in a significant modification of the old debt under § 1.1001-3 and, therefore, is not a realization event under § 1.1001-1.

.03 The new debt and the old debt are publicly traded (within the meaning of § 1.1273-2(f)).

.04 The old debt was issued at par or with a de minimis amount of original issue discount or premium. (For purposes of this condition, the de minimis amount for premium is determined using the principles of § 1.1273-1(d).)

.05 The new debt is issued at par or with a de minimis amount of original issue discount or premium. (For purposes of this condition, the issue price of the new debt is determined under § 1.1273-2 rather than under § 1.1275-2(j), and the de minimis amount for premium is determined using the principles of § 1.1273-1(d).)

.06 Neither the new debt nor the old debt is—

(1) a contingent payment debt instrument (within the meaning of § 1.1275-4),

(2) a tax-exempt obligation (as defined in § 1275(a)(3)), or

(3) a convertible debt instrument (within the meaning of § 1.1272-1(e)).

.07 All payments on the old debt and the new debt are denominated in, or determined solely by reference to, U.S. dollars, and the functional currency of the business unit issuing the new debt is the U.S. dollar.

.08 The issuer and one or more holders of the old debt make the election provided in section 4.01 of this revenue procedure.

SECTION 4. APPLICATION

.01 Election.

(1) Manner of making the election.

The issuer and the holders make the election under this revenue procedure by agreeing in writing to treat the substitution as a realization event for federal income tax purposes and to comply with the provisions of this revenue procedure. The written agreement must be entered into no later than the last day of the month in which the substitution occurs.

For example, the written agreement to make the election may be evidenced by a statement in the offering documents for the substitution that—

(a) the issuer, by distributing the documents, elects under this revenue procedure to treat the substitution as a realization event for federal income tax purposes,

(b) any holder of old debt that tenders its old debt for new debt as part of the substitution thereby makes the election under this revenue procedure, and

(c) the issuer and the holders who have tendered their old debt for the new debt (“electing holders”) will comply with the provisions of this revenue procedure.

(2) *Statement attached to return.* If an election is made under section 4.01(1) of this revenue procedure, the issuer must attach a signed statement to its timely filed (including extensions) federal income tax return for the taxable year in which the substitution occurs. On the statement, the issuer must—

(a) identify the old debt for which new debt was substituted,

(b) identify the new debt that was substituted for the old debt,

(c) indicate the issue price of the new debt, and

(d) indicate that the election was made under this revenue procedure.

.02 *Treatment of substitution.* If an election is made under this revenue procedure, the issuer and the electing holders must report the substitution for federal income tax purposes as a repurchase of the old debt in exchange for the new debt in the taxable year in which the substitution occurs. However, the issuer must account for this deemed exchange under the rules described in section 4.03 of this revenue procedure and each electing holder must account for this deemed exchange under the rules described in section 4.04 of this revenue procedure.

.03 *Issuer’s treatment.* The issuer must take into account over the term of the new debt any difference between the adjusted issue prices of the old debt and the issue price of the new debt (as determined under § 1.1273-2). If the aggregate issue price of the new debt that is transferred to electing holders as a substitute for the old debt is greater than the aggregate adjusted issue prices of the old debt for which it is substituted, the issuer treats the difference as a reduction in the aggregate issue price of the new debt. As a result, the difference is taken into account by the issuer over the term of the new debt as increased original issue discount or as reduced bond issuance premium (within the meaning of § 1.163-13). If the aggregate issue price of the new debt that is transferred to electing holders as a substitute for the old debt is less than the aggregate adjusted issue prices of the old debt for which it is substituted, the issuer treats the difference as an increase in the aggregate issue price of the new debt. As a result, the difference is taken into account by the issuer over the term of the new debt as reduced original issue discount or increased bond issuance premium.

.04 Electing holder’s treatment.

(1) *In general.* Notwithstanding any provision of subtitle A of the Internal Revenue Code (including §§ 356(a) and 1276(a)), an electing holder does not rec-

ognize any gain or loss as a result of the deemed exchange. Instead, the holder's basis (immediately after the substitution) in the new debt is the same as the holder's adjusted basis (determined as of the date of the substitution) in the debt instruments for which the new debt was substituted. In addition, the holder's holding period for the new debt includes the holder's holding period for the old debt.

(2) *Market discount.*

(a) *In general.* If the stated redemption price at maturity of the new debt (as determined under § 1.1273-1(b)) is greater than the holder's basis (immediately after the substitution) in the new debt, the holder treats the difference as market discount on the new debt and the new debt as a market discount bond (unless the amount of the discount is a de minimis amount within the meaning of § 1278(a)(2)(C)). See §§ 1276 and 1278 for the treatment of market discount. (The issue date of the old debt rather than the issue date of the new debt is used to determine whether the new debt is a short-term obligation for purposes of § 1278(a)(1)(B)(i).) See section 4.04(2)(b) below for the treatment of any accrued market discount on the old debt.

(b) *Accrued market discount.* The rules in this section 4.04(2)(b) apply if, as of the date of the substitution, there is any accrued market discount on the old debt that has not been taken into account by the holder as ordinary income. If, under section 4.04(2)(a) above, there is no market discount on the new debt or the amount of any market discount on the new debt is a de minimis amount, the amount of accrued market discount on the new debt is zero, and the accrued market discount on the old debt is ignored. If, under section 4.04(2)(a) above, the amount of market discount on the new debt is more than a de minimis amount, the lesser of this market discount and the accrued market discount on the old debt is treated by the holder, as of the date of the

substitution, as accrued market discount on the new debt. (Solely for purposes of determining the accruals of any additional market discount on the new debt, the holder's basis is increased by the amount of the accrued market discount on the old debt that is treated as accrued market discount on the new debt.)

(3) *Bond premium.* If the holder's basis in the new debt (immediately after the substitution) is greater than the stated redemption price at maturity of the new debt (as determined under § 1.1273-1(b)), the holder treats the difference as bond premium on the new debt. See §§ 1.171-1 through 1.171-5 for the treatment of bond premium.

SECTION 5. EFFECTIVE PERIOD

This revenue procedure applies to substitutions that occur between March 1, 1999, and June 30, 2000.

SECTION 6. REQUEST FOR COMMENTS

The Internal Revenue Service requests comments on this revenue procedure, including comments on whether this revenue procedure should be made permanent. Persons that wish to comment on this revenue procedure may submit comments by May 31, 1999, to: CC:DOM:CORP:R (RP-102721-99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (RP-102721-99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington DC. Alternatively, comments may be submitted via the Internet by selecting the "Tax Regs" option of the IRS Home Page or by submitting them directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. Comments will be available for public inspection.

SECTION 7. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1647.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this revenue procedure are in section 4.01. This information is required to determine whether a taxpayer has made the election under this revenue procedure. The collections of information are required to obtain a benefit. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 75 hours.

The estimated annual burden per respondent/recordkeeper varies from 1/2 hour to 1 hour, depending on individual circumstances, with an estimated average of 3/4 hour. The estimated number of respondents is 100.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

CONTACT PERSON

For further information regarding this revenue procedure, contact William E. Blanchard of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3950 (not a toll free call).