Office of Chief Counsel
Internal Revenue Service
Memorandum

Release Number: **20172901F**
Release Date: 7/21/2017

CC:LB&I:RFPH:CH2:MYChou
POSTU-134297-15

date: July 1, 2016

to: Tom R. Berg
Internal Revenue Agent
(Large Business & International)

from: Associate Area Counsel (Chicago)
(Large Business & International)

("Taxpayer")
subject: Deductibility of unamortized debt issuance costs

Disclosure Statement

This advice responds to your request for assistance. It may not be cited as precedent. This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views. This advice depends on the facts you have provided. If the facts as recited below are not correct, or have changed, please contact us for further advice.

Issue

Whether the taxpayer is entitled to deduct the unamortized debt issuance costs of its debt upon the exchange of the debt for new debt.

Conclusion

The taxpayer generally is entitled to deduct the unamortized debt issuance costs of its debt upon the exchange of the debt for new debt.

Facts

, is the taxpayer.

(" "), is the taxpayer's wholly owned subsidiary. On , 20 , entered into a credit agreement ("Credit Agreement") with a collection of lenders ("Facility Holders") that provided for term loans (" Loans") in an aggregate principal amount up to $ and a $ revolving credit facility. also entered into a second credit agreement (" Credit Agreement") with the Facility Holders that provided for additional Loans in an aggregate principal amount up to $.

On , 20 , and the Facility Holders amended the Credit Agreement and the Credit Agreement as authorized by of the Credit Agreement. At the time of the amendment, the aggregate principal amount of the outstanding Loans was $. The Loans were refinanced with new term loans referred to as " Loans." Existing Facility Holders were permitted to refinance their Loans with Loans in the same principal amount. Some of the existing Facility Holders refinanced none or some but not all of their Loans, and paid off the principal amount of the Loans that were not refinanced. There also was new borrowing of $ after the amendment, resulting in Loans in the aggregate principal amount of $. The new lenders, including the existing Facility Holders that increased their debt holdings, paid the principal amount of the Loans. The chart below illustrates the changes:

incurred a total of $ in debt issuance costs for the Loans. The taxpayer amended its Form 1120 for the tax year ending on , 20 . In the amendment, the taxpayer stated, "[t]he Company originally amortized debt issuance costs on the , 20 tax return. The Company has determined that these costs were fully deductible. The total adjustment to the debt issuance costs results in an additional deduction in the amount of $." The taxpayer is claiming it may deduct the remaining unamortized debt issuance costs for the Loans in the year of amendment as a result of the modification.

The taxpayer and the Internal Revenue Service ("Service") agree that the change in terms from the Loans to the Loans created a change in yield that constitutes a significant modification under Treas. Reg. § 1.1001-3(e)(2). [redacted]

Law

Treas. Reg. § 1.1001-3 determines whether a modification of the terms of a debt instrument results in an exchange for purposes of Treas. Reg. § 1.1001-1(a), regardless of the form of the modification. Treas. Reg. § 1.1001-3(a). "For purposes of § 1.1001-1(a), a significant modification 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." Treas. Reg. § 1.1001-3(b). Treas. Reg. § 1.1001-3(e)(2) through (6) provides specific rules for determining the significance of certain types of modifications.

Treas. Reg. § 1.446-5 provides rules for allocating debt issuance costs over the term of the debt. Treas. Reg. § 1.446-5(a) defines debt issuance costs as "those transaction costs incurred by an issuer of debt (that is, a borrower) that are required to be capitalized under [Treas. Reg.] § 1.263(a)-5." Under Treas. Reg. § 1.446-5(b)(1), "[s]olely for purposes of determining the amount of debt issuance costs that may be deducted in any period, these costs are treated as if they adjusted the yield on the debt. To effect this, the issuer treats the costs as if they decreased the issue price of the debt. . . . Thus, debt issuance costs increase or create original issue discount [("OID")] and decrease or eliminate bond issuance premium." Treas. Reg. § 1.446-5(b)(2) requires an issuer of debt with debt issuance costs treated as OID to follow the rules under Treas. Reg. § 1.163-7 to compute how much of that OID is deductible for a period.

Under Treas. Reg. 1.163-7(c),

> [I]f a debt instrument is repurchased by the issuer for a price in excess of its adjusted issue price (as defined in § 1.1275-1(b)), 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 OID.

Treas. Reg. § 1.1273-2(a) provides rules to determine the issue price of a debt instrument in an issue[1], including a debt instrument issued as a result of a significant modification under Treas. Reg. § 1.1001-3. If a substantial amount of the debt instruments in an issue is issued for money, Treas. Reg. 1.1273-2(a)(1) provides "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."

Analysis

[1] "Issue" is defined in Treas. Reg. § 1.1275-1(f).

Under Treas. Reg. § 1.446-5(b)(1) and (b)(2), for purposes of determining when the debt issuance costs are deductible, the debt issuance costs for the Loans are treated as OID, which the taxpayer takes into account under the rules in Treas. Reg. § 1.163-7. For purposes of allocating the costs to a period in accordance with Treas. Reg. § 1.163-7, the adjusted issue price of the Loans is increased by the amortization of the debt issuance costs in any prior periods. See § 1.1275-1(b) for the definition of adjusted issue price.

Under the general rule of § 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 for the taxable year in which the repurchase occurs. In general, the term repurchase includes the retirement of a debt instrument and the exchange (including an exchange resulting from § 1.1001-3) of a newly issued debt instrument for an existing debt instrument. If the issuer repurchases a debt instrument in a debt-for-debt exchange, the repurchase price generally is the issue price of the newly issued debt instrument. Treas. Reg. § 1.163-7(c).

Under a special rule in § 1.163-7(c), if a debt instrument is repurchased in a debt-for-debt exchange, any repurchase premium is generally deductible for the taxable year in which the repurchase occurs.[2] The same rule can be applied to unamortized debt issuance costs when Treas. Reg. § 1.446-5 requires that the debt issuance costs be treated as if they created OID subject to the rules in Treas. Reg. § 1.163-7.

As stated above, the taxpayer and the Service agree that the change in yield from the Loans to the Loans constitutes a significant modification under Treas. Reg. § 1.1001-3(e)(2). Under Treas. Reg. § 1.1001-3(b), the significant modification results in an exchange of the Loans for the newly issued

Loans.

The aggregate principal amount of the Loans in the issue was $. The aggregate principal amount of the Loans that were issued for money was $. As a result, the percentage of the Loans that were issued for money was approximately 51 percent. Thus, a substantial amount of the Loans was issued for money, and the issue price of each Loan in the issue is the first price at which a substantial amount of the Loans was issued for money. Treas. Reg. § 1.1273-2(a)(1). As a result, the issue price of the Loans is not determined under either § 1273(b)(4) or § 1274.

Thus, in accordance with the rules in Treas. Reg. § 1.163-7(c), the unamortized debt issuance costs allocable to the Loans repurchased for money would be deductible in the year of repurchase. In addition, the unamortized debt issuance costs

---

[2] The special rule in Treas. Reg. § 1.163-7(c) does not apply if the issue price of the newly issued debt instrument is determined under either I.R.C. § 1273(b)(4) or § 1274 (in general, a nonpublicly traded debt instrument issued for nonpublicly traded property).

allocable to the Loans repurchased in the debt-for-debt exchange would be deductible in the year of the exchange.

This advice was coordinated with FIP. Please feel free to contact me at (312) 368-8749 if you have any additional questions.

Danielle R. Dold
Associate Area Counsel (LB&I)

By: ______________________________
Mindy Y. Chou
Attorney (LB&I)

Cc: