

Fungibility of Add-On Note Offerings

This memorandum summarizes the circumstances in which an add-on offering of notes may be fungible with the original tranche for U.S. federal income tax purposes. This summary is intended to provide only a general overview of the fungibility issue — the specifics of any particular transaction should be discussed with one of our tax attorneys.

As discussed in more detail below, recently issued Treasury Regulations (the “New Regulations”) expanded (effective immediately) the circumstances under which an add-on tranche may qualify as a fungible “qualified reopening.”

An add-on tranche of notes may be fungible with the original tranche only in the following situations:

A. Both Tranches Issued Within the Same 13 Day Period

The add-on tranche is issued within the same 13 day period in which the original tranche is issued (*i.e.*, not later than 12 days after the original tranche). In applying this 13 day rule, there is some uncertainty as to whether, for tax purposes, a note should be treated as having been “issued” on the closing date or, alternatively, on the pricing date (although the consensus view seems to be on the closing date).

B. No More Than De Minimis OID on Either Tranche

Each tranche is issued at par, at a premium or with no more than de minimis OID.

C. The Add-On Tranche Is A Qualified Reopening

The add-on tranche qualifies as a “qualified reopening.” The requirements for qualified reopening treatment under the New Regulations are as follows:

1. Must Satisfy Either the Public Trading Requirement or the Cash Offering Requirement.

Prior to the adoption of the New Regulations, an add-on tranche could never qualify as a qualified reopening unless the original tranche was considered “publicly traded” for U.S. federal income tax purposes (the “Public Trading Requirement”). Under the New Regulations, an add-on tranche may qualify as a qualified reopening if the Public Trading Requirement is met or if the add-on tranche is sold to unrelated parties for an arm’s-length cash price (the “Cash Offering Requirement”).

The foregoing change is helpful but is likely to have only limited impact because the New Regulations also expand the definition of “publicly traded” (effective November 13, 2012) and, under this expanded definition, the vast majority of 144A note offerings should be considered publicly-traded.¹

¹ Under the New Regulations, a note will be considered publicly traded if, at any time within the 31-day period ending 15 days after the “announcement date” (as defined below) of the add-on offering, (1) a sale of the note has occurred and the sales price is reasonably available within a reasonable period of time after the sale or (2) a firm or indicative quote for the note is available from at least one identified broker, dealer or pricing service. There is a small issue exception -- a note will not be considered publicly traded if, at the time of the determination, the outstanding principal amount of the notes is

2. Must Satisfy (i) a 110% Yield Test (if issued within six months of the original offering) or a 100% Yield Test (if issued more than six months after the original offering) or (ii) a De Minimis OID Test (regardless of when issued).

- a. *Add-on within six months.* If the add-on offering occurs within six months of the original offering, either a “110% Yield Test” (as described below) must be satisfied or the add-on offering must price with no more than de minimis OID (the “De Minimis OID Test”).

Where the Public Trading Requirement is met, the 110% Yield Test will be satisfied if, on the “announcement date” (*i.e.*, the later of (a) seven days before pricing of the add-on offering or (b) the date on which the issuer’s intent to do the add-on offering is publicly announced through one or more media (such as Reuters, Telerate or Bloomberg)), the yield on the original tranche (based on its then trading price) does not exceed 110% of the yield on the original tranche when it was originally issued (or, if the original tranche was issued with no more than de minimis OID, 110% of the coupon rate). If the 110% Yield Test is satisfied on the “announcement date,” the add-on tranche will qualify as a qualified reopening even if the add-on tranche would not have satisfied the 110% Yield Test based on the actual pricing of the add-on tranche.

Where the Cash Offering Requirement is met (but the Public Trading Requirement is not), the 110% Yield Test will be satisfied if the yield on the add-on tranche (based on its cash offering price) is not more than 110% of the yield on the original tranche when originally issued (or, if the original tranche was issued with no more than de minimis OID, 110% of its coupon rate).

- b. *Add-on more than six months later.* Prior to the adoption of the New Regulations, an add-on offering occurring more than six months after the original offering could qualify as a qualified reopening only if the add-on offering satisfied the De Minimis OID Test. The New Regulations retain the De Minimis OID Test but also allow an add-on tranche to qualify as a qualified reopening if the add-on tranche satisfies a new “100% Yield Test.” The 100% Yield Test works exactly the same as the 110% Yield Test described above (for add-on offerings within six months of the original offering), substituting “100%” for “110%.”

The new 100% Yield Test may be helpful when the original tranche was issued within more than de minimis OID. For example, if eight-year notes were issued exactly one year ago at a price of 95, the old rules would have permitted a qualified reopening today only if the add-on tranche priced with no more than de minimis OID (*i.e.*, at a price of 98.26 or higher). The New Regulations would permit a qualified reopening if the yield on the original tranche on the announcement date or the actual cash yield on the add-on tranche (as applicable) is no more than 100% of the yield on the original tranche when it was originally issued (which would equate to a price in the range of 95.5 or higher (*i.e.*, 95 plus the portion of the OID on the original tranche that accreted during the first year)).

The new 100% Yield Test also corrects a technical glitch in the old rules that prevented any qualified reopening after six months with respect to a PIK toggle note

\$100 million or less.

CAHILL

or discount note (because such notes, even if issued at par, technically have non-de minimis OID as a result of the non-cash interest).

It should be noted that, to qualify for tax fungibility under categories A or C above, add-on notes must, at the time such notes are issued, have credit and payment terms that are identical to those of the original notes (even if it is intended that the add-on notes not become fungible until some period of time after the add-on notes are issued (e.g., after consummation of a later A/B exchange)). Accordingly, in such situations, add-on notes should be issued with “pre-issuance accrued interest” (i.e., the investors should pay, in addition to the purchase price, an amount equal to the interest that would have accrued on the add-on notes since the last interest payment date on the original tranche if the add-on notes had been outstanding during such time) so that the first interest payment on the add-on notes will be a full coupon payment identical to the corresponding interest payment on the original tranche. Pre-issuance accrued interest should be unnecessary under category B above if it is intended that the add-on notes not become fungible until after their first interest payment date — however, where the timing of making the add-on notes fungible is uncertain (e.g., upon consummation of an A/B exchange), it may be advisable to provide for pre-issuance accrued interest in any event.

* * *

If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Craig Horowitz at 212.701.3856 or chorowitz@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; or John Schuster at 212.701.3323 or jschuster@cahill.com.