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Alert
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IRS Liberalizes Original Qualified Reopening Regulations for Add-On Offerings

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Many an issuer has completed a successful debt offering and looked to close an add-on issuance thereafter, only to find itself restricted in doing so by Internal Revenue Service (IRS) regulations that apply to debt securities issued with original issue discount (OID). Thankfully, as of September 13, 2012, the IRS published new regulations (the 2012 Regulations) that expand the opportunities for issuers to undertake such add-on offerings.

Under IRS regulations dating from January 11, 2001 (the 2001 Regulations), if an issuer issues new debt as an “add on” to an existing series of notes at a price significantly less than face value, the add-on debt will not generally be treated as fungible with the original issue for tax purposes. This lack of fungibility necessitates that the add-on notes be assigned a separate CUSIP number to ensure that the securities are distinguished for tax reporting purposes. This effectively prohibits issuers from doing small add-on offerings, which will not have the necessary liquidity to make their issuance practicable.

The 2001 Regulations, which remain in effect, continue to permit an add-on issue to a “qualified reopening” if one of the two following tests is met:

- the add-on securities are issued within 6 months of the initial offering and the yield on the additional debt is not more than 10% greater than the yield on the original debt on its issue date; or
- the additional debt has no more than a *de minimis* amount of OID,[1] regardless of the time of issue of the add-on offering.

Under the 2012 Regulations, a third test has been added; additional debt securities issued more than six months after the original offering can be considered additional debt in a qualified reopening if the yield of the add-on debt does not exceed the yield of the original debt. The following example (top of next page) of an issuance of a $1,000 face value note, with an initial issue price of $960, paying a 10% coupon and maturing in 10 years, with an add-on offering one year later with an initial issue price of $962.44, demonstrates how this test works.

Original Notes - $1,000 Face Amount, $960 Issue Price 10% Coupon, 10 Year Maturity

Yield	Issue Price	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10 (Maturity)
10.67%	$960	$100	$100	$100	$100	$100	$100	$100	$100	$100	$1,100

Add-on Notes - $1,000 Face Amount, $962.44 Issue Price, 10% Coupon, 10 Year Maturity

Yield	Add-On Issue Price	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10 (Maturity)
10.67%	$962.44	$100	$100	$100	$100	$100	$100	$100	$100	$100	$1,100

Under the 2001 Regulations, if the add-on issue price was $977.50 or less, the add-on offering would not be considered a qualified reopening because it would not be considered to have a de minimis amount of OID. However, under the 2012 Regulations, the issue price of the note under an add-on offering occurring one year later could be as low as $962.44 and be deemed fungible with the original issue, as both the original and add-on notes would have a yield of 10.67%. Additionally, in order for there to be a qualified reopening under the 2001 Regulations, the original notes were required to be publicly traded; the 2012 Regulations have largely eliminated this requirement unless the issuer and the debt holder are related.

As a result of the 2012 Regulations, we expect that issuers will have greater flexibility to re-open debt offerings with OID after six months of the original offering.

1 A debt instrument will generally have *de minimis* OID if the issue discount is less than 0.25% multiplied by the number of full years to maturity of the instrument.

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