

bility or exemption issue while considering the request, that issue will remain outside the scope of the VCAP submission because it was not voluntarily brought forward by the organization.

*.05 Verification.* As part of the processing of the VCAP submission, the Service reserves the right to verify that corrections have been made to the eligible organization's tax, withholding, and reporting procedures on payments to alien individuals. Verification of such corrections does not constitute an examination of the books and records of the organization. If the Service determines that the eligible organization has not implemented or does not plan to implement the proper corrections and procedures, the case may be considered for examination. The Service does not contemplate opening examinations on VCAP submissions but reserves the right to do so. If the Service decides to examine the eligible organization, the examination will be commenced and completed as soon as possible, with the intention in most cases that the scope of the examination will be limited to tax and withholding obligations on payments to alien individuals and related issues.

*.06 Acknowledgment letter.* If the Service is satisfied at the conclusion of its review that the organization has instituted policies and procedures which ensure that the correct amounts of taxes on payments to alien individuals are withheld, paid, and reported to the Service on the proper forms and in a timely manner, then the Service will issue to the eligible organization an acknowledgment letter indicating that based upon its review, the eligible organization is at that time in substantial compliance with the tax, withholding, and reporting obligations governing payments to alien individuals. Once the organization has received an acknowledgment letter at the completion of the VCAP process, and provided that the organization in fact complies with the agreed upon withholding, payment and reporting procedures, the information submitted by the organization to the Service under VCAP will not be used as the basis to initiate an examination of the organization.

*.07 Failure to reach resolution.* If resolution cannot be reached because sufficient information is not timely provided to the Service or because agreement cannot be reached on correction or administrative

procedures, the Service may consider the case for examination.

*.08 Applicability of §§ 6103 and 6110.* The information received or generated by the Service under VCAP is subject to the confidentiality requirements of § 6103 of the Code. The acknowledgment letter is not a written determination letter within the meaning of § 6110 of the Code.

*.09 Conferences.* If the Service initially determines that it cannot issue an acknowledgment letter because the parties cannot agree upon some correction or administrative issue, the organization or the organization's representative may be granted a conference with the Service, at the Service's discretion and upon request by the organization or the organization's representative. The conference can be held either in person or by telephone. If a conference is offered, the organization or its representative will be contacted by the Service representative.

## SEC. 6. EFFECTIVE DATE AND SUNSET DATE

VCAP is effective on February 26, 2001. It will be available for submissions made on or before February 28, 2002.

## SEC. 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 in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545-1735.

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 control number.

The collections of information contained in this revenue procedure are in section 4.02 and section 4.03(2). This information will enable the Service to determine whether an organization qualifies for VCAP. The likely respondents are public and other not-for-profit colleges and universities and certain other charitable organizations.

The estimated total annual reporting burden is 346,500 hours.

The estimated average annual burden per respondent is 700 hours. The estimated number of respondents is 495.

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.

## SEC. 8. DRAFTING INFORMATION

The principal authors of this revenue procedure are Lowell G. Hancock of the Office of Pre-Filing Services, and Virginia Richardson of the Tax Exempt/Government Entities Division. For more information concerning VCAP, contact Mr. Hancock at (202) 874-1800 or (330) 375-5421 (not toll-free numbers), Ms. Richardson at (202) 283-8938 (not a toll-free number), or Neil Shepherd of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities) at (202) 622-6040 (not a toll-free number).

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

## Rev. Proc. 2001-21

### SECTION 1. PURPOSE

This revenue procedure provides an election that will facilitate the substitution of newly issued debt instruments for outstanding debt instruments. 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 otherwise 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.

This revenue procedure modifies and supersedes Rev. Proc. 99-18, 1999-1 C.B. 736, which, as modified by Rev. Proc. 2000-29, 2000-28 I.R.B. 113, applies to substitutions that occur on or

after March 1, 1999. The significant changes to Rev. Proc. 99-18 are as follows:

.01 The newly issued debt may be debt issued in a qualified reopening;

.02 The outstanding debt may have been issued with premium; and

.03 The determination of whether a substitution does or does not result in a significant modification may be made on the substitution date or, in most cases, on the date that is two business days before the date on which the substitution offer commences.

## SECTION 2. BACKGROUND

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

.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(b), a modification of a debt instrument results in an exchange for purposes of § 1.1001-1(a) if, and only if, the modification is significant.

.03 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). 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 the yield or in 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 outstanding debt instruments in a way that increases the liquidity of the issuer's debt by concentrating more of the issuer's outstanding debt in a smaller number of issues. In general, if the terms of the newly issued debt are not materially different from the terms of the outstanding debt, substituting the newly issued debt for the outstanding debt does not result in a significant modification of the outstanding debt under § 1.1001-3. Therefore, the substitution of the newly issued debt for the outstanding debt in the refinancing and consolidation is not a realization event for federal income tax purposes. Under § 1.1275-2(j), however, some or all of the newly issued debt may have original issue discount in varying amounts, depending upon the terms of the outstanding debt for which the newly issued debt was substituted. As a result, the newly issued 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 Either—

(1) Debt instruments from a single new issue ("new debt") are substituted for debt instruments from two or more outstanding issues of debt ("old 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 outstanding issues.); or

(2) Debt instruments issued in a qualified reopening (as defined in

§ 1.1275-2) ("new debt") are substituted for debt instruments from one or more outstanding issues of debt ("old debt").

.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. This determination may be made either on—

(1) the substitution date, or

(2) the date that is two business days before the date on which the substitution offer commences, provided that date is no more than 30 business days before the date on which the substitution offer ends.

.03 The new debt and the old debt are publicly traded (within the meaning of § 1.1273-2(f)). If the new debt is issued in a qualified reopening of an outstanding issue of debt, that outstanding issue was also publicly traded.

.04 The old debt was issued at par, at a premium, or with less than a *de minimis* amount of original issue discount (within the meaning of § 1.1273-1(d)).

.05 The new debt is issued at par or with less than 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 for federal income tax purposes in the

manner described in section 4.02 through section 4.04 of this revenue procedure and to comply with all other 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, and if the issuer must file a federal income tax return for the taxable year in which the substitution occurs, 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 (or, if the new debt is issued in a qualified reopening, the adjusted issue price of the new debt immediately after the substitution), 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. The issuer, however, 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.*

(1) *In general.* Except as provided in section 4.03(2) of this revenue procedure, the issuer must take into account over the term of the new debt any difference between the adjusted issue prices of the old debt at the time of the substitution 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.

(2) *Qualified reopening.* If the new debt is issued in a qualified reopening, the issuer applies the rules in section 4.03(1) of this revenue procedure by using the remaining term of the new debt instead of the term of the new debt and by using the adjusted issue price of the new debt immediately after the substitution instead of the issue price of the new debt.

.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 recognize 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 *de minimis* 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 *de minimis*, 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 *de minimis*, 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. EFFECT ON OTHER DOCUMENTS**

Rev. Proc. 99–18, as modified by Rev. Proc. 2000–28, is modified and superseded.

**SECTION 6. EFFECTIVE DATE**

This revenue procedure applies to substitutions that occur on or after March 13, 2001. For substitutions that occur before March 13, 2001, Rev. Proc. 99–18, as currently in effect, continues to apply.

**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 an election has been made 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 the Associate Chief Counsel (Financial Institutions and Products) at (202) 622–3950 (not a toll-free call).

26 CFR 601.202: Closing agreements. (Also Part I, sections 446, 482, 7121; 1.446-1, 301.7121-1)

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