

## message from partner in charge

As the third quarter draws to a turbulent end, this issue of the newsletter offers our clients and friends vital information.

In an article adapted here, Mr. Bortnick and Mr. Nickel discuss an Internal Revenue Service response to the current financial crisis — a temporary Revenue Procedure designed to shelter certain debt instruments from AHYDO rules.

Mr. Letizia's and Mr. Ricciardi's article, "Time Is On Your Side: Permit Extension Act Becomes Law in New Jersey," explains the Permit Extension Act of 2008. Signed into law by New Jersey Gov. Jon Corzine on Sept. 6, the act extends permit and approval periods, and, with some restrictions, is intended to address the economic difficulty the building industry faces.

In cyberspace, our recent Webinar looked ahead to what the financial services industry might expect from either a McCain or an Obama administration.

As always, we welcome your comments on this newsletter and your suggestions for future issues.

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## IRS Releases Certain Debt Instruments From AHYDO Grip

This article is condensed for space, but not content. See the original version at [http://www.pepperlaw.com/pepper/publications\\_update.cfm?rid=1500.0](http://www.pepperlaw.com/pepper/publications_update.cfm?rid=1500.0).

On August 8, the IRS' Revenue Procedure 2008-51 comforted corporate borrowers that certain financing commitments before January 1, 2009 will not become subject to rules limiting deductibility of interest on debt instruments. The Procedure exempted three types of debt obligations from being treated as applicable high yield discount obligations (AHYDOs). Because instruments likely will be sold at discount by issuers in this shaky financial market, without this guidance certain corporate borrowers may have otherwise seen their instruments swept into AHYDO rules.

### *Original Issue Discount Rules*

To know how and why the IRS notice helps taxpayers, some discussion of original issue discount (OID) is necessary. OID is the excess of a instrument's stated redemption price at maturity (redemption price) over its issue price. The redemption price generally is the total of payments required over the instrument's life, other than stated interest required to be paid in cash or property other than instruments at least annually. Example: if a bond issued for \$80 pays no interest prior to maturity and is redeemable at maturity for \$100, the bond's OID is \$20, accruing over the term of the instrument at the yield on the bond. The holder must take the accrued OID into income over the holding period. On the other hand, the bond's issuer generally is permitted to deduct as an interest expense the accrued OID over the bond's term, subject to complex rules.

Because OID is the excess of a instrument's redemption price over its issue price, determining the issue price is critical, and OID rules contain specific rules for determining the issue price. For example, the issue price of a publicly offered instrument issued for cash is the offering price to the public (ignoring bond houses and brokers) at

which a substantial amount of the instrument was sold. For a non-publicly issued instrument issued for cash, the issue price for each instrument is the first buyer's price. The issue price of an instrument either publicly traded or issued for property that is publicly traded is the fair market value of the traded property.

Treasury Regulations provide that if the instrument is materially modified (e.g., the term or interest rate is changed more than an amount the Regulations specify), the instrument is treated as being reissued for a new instrument. The issue price of the new instrument is determined under the OID rules described above. Accordingly, if the new instrument's issue price is lower than the redemption price (e.g., because it is publicly traded and has dropped in value), the new instrument will have OID, which may exceed the original instrument's OID.

#### *AHYDO Rules*

AHYDO rules limit a taxpayer's ability to deduct OID as interest on certain corporate instruments, and when the rules apply, no deduction is allowed for the OID's "disqualified portion," which is treated as a corporate distribution for purposes of the dividends received deduction available to corporate holders. The disqualified portion is the yield in excess of the applicable federal rate plus 6 percentage points. The remaining OID on any AHYDO is deductible only when paid. This raises issues for the borrower (which would like a deduction for what is, in essence, an interest expense) and for lenders (because more taxes mean less cash flow with which to pay debt service). So it usually is important to both the borrower and lender to ensure that, consistent with economic terms to which the parties agreed, AHYDO rules are not brought into play.

An AHYDO is an instrument that: 1. is issued by a corporation (although AHYDO rules only apply to the corporate partner(s)), 2. has a term exceeding five years, 3. has a yield to maturity that equals or exceeds the sum of the applicable federal rate plus 5 percentage points, and 4. has "significant OID."

#### *IRS Relief - Revenue Procedure 2008-51*

The IRS highlighted two situations where worsening market conditions could affect the issue price of a financing commitment.

First, when a corporation issues debt with essentially permanent terms (not subject to renegotiation after temporary "bridge" terms expire), the lender, acting as

## Obama and McCain: What Would They Do For (Or To) You Webinar

Whatever choice the voters make in November, it's likely that the current federal regulatory approach to the financial services industry will change, perhaps dramatically. We've all heard the campaign rhetoric, but few have probed deeply into the specifics of both candidates' positions on matters affecting financial services business.

What would Sen. Barack Obama's proposal for a foreclosure prevention fund mean for mortgage lenders already struggling for survival? What would Sen. John McCain do to address the financial issues at Fannie Mae and Freddie Mac, or other aspects of the ongoing credit crisis?

Listen as we examine the policies of both candidates regarding financial services regulation and related issues.

Visit Pepper's webinar section at [www.pepperlaw.com](http://www.pepperlaw.com) to view the webinar recording and download the PowerPoint slides from this online event.

an underwriter, may be unable to sell the debt to third parties for a price equal to the amount the corporation received under the financing commitment. In this case, the result could be that the lender deeply discounts the debt obligations, causing a drop in issue price (because the price paid by the lender in its capacity as an underwriter is ignored in determining issue price), compared to the money advanced to the corporation.

Second, when a corporation issues debt subject to "bridge" terms established in the financing commitment, the corporation may be only able to refinance this debt under less favorable "permanent" terms. Thus, the corporation and the lender may negotiate to amend the debt's terms, so it can be marketed. Certain amendments may constitute material modifications, and thus the debt would be treated as reissued for a new instrument. The issue price of the "new" instrument may have an issue price lower than the amount initially advanced to the corporation, for example, if the instrument is publicly traded and the fair market has gone down.

Each of these cases potentially results in OID creation as a result of adverse market conditions. If the OID is significant, the instrument may be an AHYDO. The IRS wanted to alleviate uncertainties generated by current market conditions. Revenue Procedure 2008-51 covers three specific types of instruments issued under a financing commitment, generally, instruments issued for money, or exchanged or indirectly exchanged for instruments issued under a financing commitment.

Specifically, under Revenue Procedure 2008-51's terms, these instruments will not be treated as AHYDOs:

1. An instrument issued for money if (a) the instrument's terms are consistent with the general terms of a binding financing commitment obtained by the corporation from an unrelated party before January 1, 2009; and (b) the instrument would not have been an AHYDO if the issue price were equal to the net cash proceeds actually received by the issuer.
2. An instrument issued in exchange (including a deemed exchange resulting from a material modification) for a instrument if (a) the terms of the original instrument are consistent with the general terms of a binding financing commitment obtained by the corporation from an unrelated party before January 1, 2009; (b) the new instrument is issued within 15 months following the issuance of the old instrument; (c) the instrument would not be an AHYDO if the instrument's issue price was the net cash proceeds actually received by the issuer for the old instrument; (d) the new instrument's maturity date is not more than one year later than that of the old instrument; and (e) the new instrument's redemption price is not greater than that of the old instrument.
3. An instrument issued in exchange (including a deemed exchange resulting from a material modification) for a instrument if (a) the old instrument is described in 2; (b) the new instrument is issued within 15 months following the issuance of the old instrument; (c) the instrument would not be an AHYDO if the instrument's issue price was the net cash proceeds actually received by the issuer for the original instrument; (d) the new instrument's maturity date is not more than one year later than that of the original instrument; and (e) the new instrument's redemption price is not greater than that of the original instrument.

### *Pepper Perspective*

Revenue Procedure 2008-51 gives taxpayers some relief and certainty against potentially adverse tax consequences arising solely because of current poor market conditions. However, the IRS has clearly marked the limited cases covered by the Procedure. Taxpayers are instructed that they may not use this guidance to infer other rules regarding whether a instrument would be within the AHYDO rules' scope. Moreover, the Procedure's "fix" is temporary, (as we hope the conditions necessitating the Procedure will be). Corporate borrowers intending to modify instruments, or whose debt is being sold by intermediaries, should consider (with their tax advisors) whether these conditions apply to their instruments, to determine whether the Procedure's relief applies.

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**It is with great sorrow that we mourn the passing  
of our partner, colleague, mentor and friend.**



**Dennis R. Casale, Esq.**  
**(1953-2008)**

## Time Is on Your Side: Permit Extension Act Becomes Law in New Jersey

On September 6, New Jersey Gov. Jon Corzine signed into law legislation that will widely affect approved development projects in the state. The Permit Extension Act of 2008 (PEA) tolls or suspends the period of approval for many types of state, county and local development permits from January 1, 2007 through July 1, 2010. The legislation also provides for an additional, potential phase-in period of up to six months, to December 31, 2010. The maximum extension period would be four years.

The PEA is intended to address the economic difficulties the building industry is facing. The law's final form was a compromise between the interests of the business and development communities, which sought a long-term extension period for all development approvals, and the interests of environmental groups, which sought a limited extension period for only a handful of permits. As a result, not all development-related permits are eligible for the extension benefits under the PEA.

The law extends the life of state, county, regional and municipal permits and approvals, which are typically required for subdivision and site plan approval. However, permits and approvals **not extended** under the PEA include:

1. Permits and approvals issued by the federal government or any of its agencies. The duration and expiration terms of such permits are determined under federal law or regulation.
2. Approvals in these "environmentally sensitive areas:"
  - State Plan Planning Area 4B (Rural Environmentally Sensitive), Planning Area 5 (Environmentally Sensitive) and a critical environmental site (CES) as designated under the version of the State Plan in effect at the time the PEA was signed.
  - the Highlands, except for a growth area under the Highlands Regional Master Plan.
  - the Pinelands, except for growth areas designated in the Pinelands Comprehensive Management Plan.
3. New Jersey Department of Transportation permits, except for access and right-of-way permits.
4. Flood Hazard Area Control Act permits, except where work has begun on any site improvements or on any buildings.

5. Coastal Center designations where an application for Plan Endorsement was not submitted to the State Planning Commission as of March 15, 2007 and designations were not in compliance with the Coastal Management Rules. Under the law, all Coastal Area Facility Review Act (CAFRA) permits are extended.
6. Administrative Consent Orders issued by the NJDEP.

The tolling/extension of the PEA does not prohibit granting of additional extensions a party would otherwise be entitled to under existing laws after the PEA's tolling period expires. Developers could, therefore, piggyback extensions provided by the PEA and those achievable under other statutes, such as the Municipal Land Use Law.

The Permit Extension Act of 2008 can be an invaluable tool for developers in these difficult economic times. Given the broad range of development permits and approvals included in the legislation, and the exceptions noted above, the status of approvals for pending and ongoing development must be evaluated on a case-by-case basis. Pepper can assist with this evaluation and help you determine if indeed time is on your side.

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