Client Alert

October 2019

Treasury Publishes Proposed Regulations Intended to Ease Transition from LIBOR

On October 9, 2019, the US Department of the Treasury (Treasury) published proposed regulations addressing the federal income tax consequences of modifications to the terms of debt, derivative and other financial contracts related to the replacement of LIBOR-based rates with other reference rates. Fortunately, the proposed regulations reflect a taxpayer-friendly approach to the potential issues raised by LIBOR transition.

Under current Treasury regulations, modifying or amending the terms of a debt instrument or nondebt contract, like a derivative, to replace LIBOR with a different reference rate could result in the realization of income, deduction, gain or loss for federal income tax purposes or could result in other material negative federal income tax consequences. Among other changes, the proposed regulations provide that replacing LIBOR with a qualified rate or providing a fallback to LIBOR in a debt instrument or nondebt contract generally will not result in a deemed exchange of the instrument so long as the replacement rate does not change the fair market value of the debt instrument or nondebt contract (taking into account any one-time payment made in connection with the modification). In general, the replacement rate must also be based in the same currency as the original rate. And, pursuant to the proposed regulations, any reasonable, consistently applied valuation method can be used to determine fair market value. To facilitate the determination of fair market value, the proposed regulations provide two safe harbors, one based on a comparison of historic rates and one on arm's-length negotiations, where the fair market value will be deemed to be substantially equivalent to the prior rate. While these safe harbors and the proposed regulations generally are welcome and certainly are intended to provide taxpayer relief, many questions, both technical and practical, remain as to how the safe harbors will apply in many situations.

The proposed regulations apply to both the issuer and holder of a debt instrument, and to each party to a nondebt contract. Taxpayers and their related parties may apply the proposed regulations to alterations and modifications that occur before the regulations are finalized, provided that the taxpayer and its related parties consistently apply the rules before that date. The proposed regulations also provide other paths for reliance when the regulations are finalized.

In the press release announcing the proposed regulations, Treasury Secretary Mnuchin said the proposed regulations are intended to "provide certainty and clarity to taxpayers as they make the critical transition away from LIBOR." The Treasury and the IRS encourage written comments on the proposed regulations by November 25, 2019. If you would like more information about the proposed regulations or provisions to include in loan documents or other corporate debt instruments regarding LIBOR fallback rates, please contact one of the attorneys listed below.

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