November 7, 2002

The Honorable Pamela F. Olson
Assistant Secretary (Tax Policy)
Department of the Treasury
Room 1334 MT
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Robert E. Wenzel
Acting Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
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Ladies and Gentlemen:

I am pleased to enclose the New York State Bar Association Tax Section's Report No. 1022, which responds to the request in Notice 2002-36, I.R.B. 2002-22, for recommendations concerning the proper tax treatment of straight (*i.e.*, noncontingent) and contingent convertible debt.

Our report focuses first on the tax treatment of straight convertible debt from the issuer's viewpoint. It identifies three possible approaches for accounting for the issuer's interest deductions with respect to straight convertible debt: (1) the bifurcation method, (2) the traditional method, and (3) the contingent payment method. After discussing the pros and cons of each approach, the report concludes that, on balance, the traditional method remains the most appropriate way to account for interest expense on straight convertible debt.

The report then discusses the appropriate treatment of the issuer of contingent convertible debt if the traditional method is retained for straight convertible debt. It concludes that, under such circumstances, a modified contingent payment method should be adopted, one that accrues original issue discount based upon the yield to maturity at which the issuer could have issued comparable straight convertible fixed rate debt. Under such a method, a contingent convertible debt instrument having relatively insignificant contingent payments (other than the conversion right) would be taxed in a manner that approximates the traditional method.

Finally, the report discusses how holders of both straight and contingent convertible debt should be taxed. It concludes that, on balance, holders should continue to be taxed in a manner symmetrical to that of issuers.

Respectfully submitted,

Samuel J. Dimon
Chair

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