WHITE & CASE

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Tips for Taps

Following a successful bond issuance, an issuer may consider a "tap" issuance as a way to access further funding.

White & Case offers some "Tips for Taps" for issuers and underwriters in accessing the capital markets through a tap issuance.

Why tap?

A tap issuance has certain advantages over a standalone new issuance of bonds.

- **Potentially attractive pricing** – if bonds are trading attractively on the open market, an issuer may be able to take advantage by offering bonds at a premium to par. This may reduce the all-in cost of funding for an issuer for the increased amount of bonds. The new issuance itself may have an effect on market price (either positive or negative) which may exacerbate this effect.
- **No re-negotiation of terms** – a tap issuance is issued under the same contract as the initial series of bonds. Provided the initial trust deed/indenture/terms and conditions permits additional series of bonds to be issued, the tap bonds will be fungible, meaning they will have the exact same terms (coupon, CUSIP/ISIN, etc.) as the initial series. This locks in pricing, redemption schedules and covenants, as well as administrative matters such as interest payment dates, which the issuer can continue to take advantage of for a larger portion of its capital structure.
- **Quantum** – given liquidity concerns for investors, a standalone bond transaction typically requires a minimum quantum of at least €125 million to €150 million. A tap offering does not require the same transaction size, and may be issued in a smaller amount for a specific targeted purpose such as an acquisition or refinancing of other indebtedness on more attractive terms.
- **No green shoe available** – unlike equity offerings, debt offerings generally do not give the underwriters the option to purchase additional securities. Instead, an issuer must tap to meet additional investor demand following an initial issuance. While equity shoe exercises customarily occur within 30 days of the initial offering for up to 15 percent of the issuance, taps are generally more flexible.
- **Streamlined process and documentation offering speed of execution** – as discussed below, a tap leverages off the work done on the initial bond issuance, offering significant advantages in time and expense with an immediate tap following closing (or even between pricing and closing) possible.

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The price is right

Since many issuers, particularly after a debut issue, will prefer a process which is streamlined, a tap should make commercial sense. A tap can issue at either a premium or at a discount (or at par), depending on the relevant circumstances.

- **Premium** – if bonds are trading above par, a premium may be charged on the bonds which will adjust the price to reflect the market. This reduces the all-in-yield for an investor.
- **Discount** – if bonds are trading below par, investors need to be offered a discount on the bonds. This increases the all-in-yield for an investor.

In either case, given there will likely be accrued interest on the bonds, an investor will normally pay an additional amount to reflect this (which they receive back on the next interest payment date).

The tax implications of such premium and discount are considered below.

Turning on the tap

Once a decision to tap rather than issue a standalone bond is taken, the issuer can quickly begin to prepare for the new offering. The key processes and documentation will primarily be driven by the time elapsed since the initial bond issuance. For example, the extent to which disclosure updates are required will increase as time passes. While a tap typically offers an efficient course of action, it is a standalone securities offering from a liability perspective, and accordingly, all necessary steps need to be taken in this regard.

- **Due diligence** – the issuer should consider what has changed in its business since the initial bond issuance. Are there any business updates, a change of company focus or any regulatory changes on the horizon? Has the company made any material acquisitions/dispositions? As most issuers will have been publishing periodic reports since their initial bond issuance, many of these points will already have been considered and disclosed to the market. A tap issuance offering memorandum (either standalone or supplement) will bring these developments together, to provide an updated picture of the issuer at the time of the tap issuance.

Top Tap Tip #1

When setting up a data room for your tap issuance, it may make sense to open your old data room, with just one folder for updated documents. Counsel can then target the new documents quickly and efficiently, as well as cross-referring to the old due diligence documents.

- **Offering memorandum** – the offering memorandum will be updated to reflect the due diligence findings/issuer developments. This can either take the form of a supplement to the initial offering memorandum or a fully updated standalone offering memorandum. A supplement, which will incorporate/wrap the initial offering memorandum, will be the quicker to prepare and may only extend to a few pages, incorporating any key disclosure updates, the key terms of the offering, as well as a few updated key disclosure sections to reflect the offering, namely, "Use of Proceeds" and "Capitalization." A supplement would be the preferred method if a decision to tap were made between pricing and closing. An updated standalone offering memorandum will typically be required in the event of any significant disclosure updates, or more likely, in the event that the tap offering requires a revised "Management's Discussion and Analysis" and a further set of financial statements to be included in the offering memorandum, which is often the case due to the "135-day rule" for auditor negative assurance.

Top Tap Tip #2

At the tap kick-off, provide all reports, publications and financial statements post-initial issuance to counsel in Word format, to allow them to efficiently update the offering memorandum.

- **Process and documentation** – a tap issuance should be able to leverage off all work done on the initial transaction because the new bonds will be fungible (same terms, CUSIP/ISIN, etc.). This includes the underwriting agreement, legal opinions, auditor comfort letters and corporate authorizations and certificates. Identify early in the process whether any transaction party will need to deviate from the documentation in the original transaction. There may be legitimate reasons for doing so, such as internal corporate reasons or change of policy. Be mindful of these, given the number of transaction parties and fast moving markets. Identifying deviations from the original documentation early in the process will save time later.
- **Structuring** – in the case of tapping a secured or guaranteed deal, consideration needs to be given as to ensuring the new bonds benefit from the same security and guarantees as the original bonds. First, most obviously, the existing bonds and other applicable debt documents must allow for the new issuance on the terms contemplated. Then depending on the original guarantee terms and security documents (including the intercreditor agreement) matching credit support can typically be established. For example, in some jurisdictions, further issuances can be built into the security documents, in others, multiple security documents may be required, with equality provided through an enforceable intercreditor agreement. The existing debt documents may contain certain opinion, officer certificate or other deliverable requirements to ensure holders of the original bonds are not prejudiced in the establishment of the extended security or guarantees.

Mirror image

In circumstances where an issuer would like to issue new bonds under an existing trust deed/indenture but there are legal, tax or other restrictions on doing so, all is not lost. Many trust deeds/indentures allow for a series of new bonds to be issued under the existing contract with a separate CUSIP/ISIN number but otherwise identical to the existing bonds ("**mirror bonds**"). While these mirror bonds would not be fungible with the existing bonds and thus would require a certain size to obtain stand-alone liquidity, they would otherwise obtain many of the other benefits described herein.

Tax tips for taps

Tax implications for taps vary by location. Tax considerations for a few frequently encountered jurisdictions are outlined below.

- **United States** – An issuer (whether US or non US) should only tap if the original and tap issues are treated as a fungible issue under US tax law. Generally, tap bonds will be treated as fungible with the original bonds for US federal income tax purposes when the tap issue:

  1. is issued with no more than a ***de minimis* amount of original issue discount (OID)**;

  > **Top Tap Tip #3**
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  > *De minimis* OID is generally an amount *less* or *equal* to: 0.25 percent *times* the stated redemption price at maturity, *times* the number of complete years to maturity from the issue date.
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  > However, the threshold for bonds subject to certain contingencies might be calculated differently. Please consult with your tax counsel to ensure that a tap will be fungible.

  2. **occurs within 13 days** of the original issue;

  3. **occurs within 6 months of the original issue date**, if on the earlier of the announcement or pricing dates of the tap bonds, the yield of the original bonds (based on their fair market value) is not more than 110 percent of the yield of the original bonds on their issue date (or, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate);

  4. **occurs after 6 months of the original issue date**, if on the earlier of the announcement or pricing dates of the tap bonds, the yield of the tap bonds (based on their fair market value or cash purchase price, as applicable) is not more than 100 percent of the yield of the original bonds on their issue date (or, if the original bonds were issued with no more than a *de minimis* amount of OID, the coupon); or

  5. is in respect of original bonds issued with OID and is issued at a price that is not less than the "adjusted issue price" of the original bonds.

  > **Top Tap Tip #4**
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  > A non-fungible tap may adversely affect the trading price and, therefore, is a disclosure issue. Depending on the circumstances, a non-fungible tap of a "grandfathered debt instrument" within the meaning of FATCA (Sections 1471 through 1474 of the US Internal Revenue Code of 1986, as amended) may not be grandfathered and because it will not be possible to distinguish between the original debt instruments and the tap, both the original debt instruments and the tap may be subject to FATCA withholding.

  Tap issues under 1, 3, 4 and 5 above are known as "qualified reopenings". Note that we have experienced on a number of occasions the Clearing Systems refusing to accept tap bonds in Regulation S offerings without an opinion of counsel to the effect that the tap bonds are fungible with the original bonds for US federal income tax purposes. Some underwriters have also declined for reputational issues to underwrite non-fungible re-taps in Regulation S offerings given the potential for flow-back to the US and the potential tax implications for holders of the original issuance.

- **Italy** – An issuer can only tap an existing bond issue, so that the new bonds carry (and rely on) the same ISIN code as the existing bonds and are treated the same as the initial issuance for Italian fiscal purposes, if the original and tap issues are treated as fungible from an Italian tax law perspective. The relevant legislation is Legislative Decree 239/1996 ("**Decree 239**"). Generally, under Decree 239, tap bonds are fungible with the original bonds when the tap issuance:

  1. **occurs within 12 months** of the original issue; and

  2. the difference between the issue price of the existing bonds and the new bonds is less than 1 percent multiplied by the number of complete years remaining until the maturity date (with market practice having developed in the calculation of this figure).

  For tax purposes, the discount is considered as interest and as such is covered by Decree 239. Should the bonds be issued by a non-Italian issuer and all held by non-Italian investors, the Italian tax regime should not be relevant since both the issuer and the investors are non-Italian subjects. However, if (a) the bonds can be placed with Italian investors that are not banks and/or companies; or (b) it is possible that these bonds are traded among Italian investors that are not banks and/or companies, the conservative approach would be to apply the conditions described at points 1 and 2 above to any reissuance.

- **France** – In France, there is no specific tax treatment for tap issues. Note that in the case of bonds issued with a premium of more than 10 percent of the nominal value, under certain conditions, the tax deduction of such premium, which is considered as interest expense for French corporate income tax purposes, will have to be deferred over the lifetime of the bonds.

- **Germany** – Due to German tax reforms in 2008, since 2009, a bond tap in Germany will be treated the same for tax purposes as the initial issuance, notwithstanding any OID or time elapsed since the initial issuance, at a flat rate for all private investors (depending on any specific considerations for the tax payer).

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