Corrections

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Department of the Treasury

Internal Revenue Service

26 CFR Part 1

[TD 8927]

RIN 1545-AW34

Conversion to the Euro

Correction

In rule document 01–252 beginning on page 2215 in the issue of Thursday, January 11, 2001, make the following correction:

PART 1 [CORRECTED]

On page 2217, second and third columns, *Example 1* and *Example 2* of §1.985–8 (c)(3)(ii) is reprinted to include the missing euro signs.

§1.985–8 [Corrected]

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(c)(3)(ii) * * *

Example 1. X, a calendar year QBU on the cash method of accounting, uses the deutschmark as its functional currency. X is not described in section 1281(b). On July 1, 1998, X converts 10,000 deutschmarks (DM) into Dutch guilders (fl) at the spot rate of fl1 = DM1 and loans the 10,000 guilders to Y (an unrelated party) for one year at a rate of 10% with principal and interest to be paid on June 30, 1999. On January 1, 1999, X changes its functional currency to the euro pursuant to this section. Assume that the euro/deutschmark conversion rate is set by the European Council at 1= DM2. Assume further that the euro/guilder conversion rate is set at 1 = fl2.25. Accordingly, under the terms of the note, on June 30, 1999, X will receive 4444.44 (fl10,000/2.25) of principal and 444.44 (fl1,000/2.25) of interest. Pursuant to this paragraph (c)(3), X will realize an exchange loss on the principal computed under the principles of § 1.988–2(b)(5). For this purpose, the exchange rate used under § 1.988–2(b)(5)(i) shall be the guilder/euro conversion rate. The amount under § 1.988–2(b)(5)(ii) is determined by translating the fl10,000 at the guilder/deutschmark spot rate on July 1, 1998, and translating that deutschmark amount into euros at the deutschmark/euro conversion rate. Thus, X will compute an exchange loss for 1999 of 555.56 determined as follows: [4444.44 (fl10,000/2.25)–5000 ((fl10,000/1)/2) = – 555.56]. Pursuant to this paragraph (c)(3), the character and source of the loss are determined pursuant to section 988 and regulations thereunder. Because X uses the cash method of accounting for the interest on this debt instrument, X does not realize exchange gain or loss on the receipt of that interest.

Example 2. (i) X, a calendar year QBU on the accrual method of accounting, uses the deutschmark as its functional currency. On February 1, 1998, X converts 12,000 deutschmarks into Dutch guilders at the spot rate of fl1 = DM1 and loans the 12,000 guilders to Y (an unrelated party) for one year at a rate of 10% with principal and interest to be paid on January 31, 1999. In addition, assume the average rate (deutschmark/guilder) for the period from February 1, 1998, through December 31, 1998 is fl1.07 = DM1. Pursuant to § 1.988–2(b)(2)(ii)(C), X will accrue eleven months of interest on the note and recognize interest income of DM1028.04 (fl1100/1.07) in the 1998 taxable year.

(ii) On January 1, 1999, the euro will replace the deutschmark as the national currency of Germany pursuant to the Treaty on European Union signed February 7, 1992. Assume that on January 1, 1999, X changes its functional currency to the euro pursuant to this section. Assume that the euro/deutschmark conversion rate is set by the European Council at 1 = DM2. Assume further that the euro/guilder conversion rate is set at 1 = fl2.25. In 1999, X will accrue one month of interest equal to 44.44 (fl100/2.25). On January 31, 1999, pursuant to the note, X will receive interest denominated in euros of 533.33 (fl1200/2.25). Pursuant to this paragraph (c)(3), X will realize an exchange loss in the 1999 taxable year with respect to accrued interest computed under the principles of § 1.988–2(b)(3). For this purpose, the exchange rate used under § 1.988–2(b)(3)(i) is the guilder/euro conversion rate and the exchange rate used under § 1.988–2(b)(3)(ii) is the deutschmark/euro conversion rate. Thus, with respect to the interest accrued in 1998, X will realize exchange loss of 25.13 under § 1.988–2(b)(3) as follows: [488.89 (fl1100/2.25)– 514.02 (DM1028.04/2) =– 25.13]. With respect to the one month of interest accrued in 1999, X will realize no exchange gain or loss since the exchange rate when the interest accrued and the spot rate on the payment date are the same.

(iii) X will realize exchange loss of 666.67 on repayment of the loan principal computed in the same manner as in Example 1 [5333.33 (fl12,000/2.25)– 6000 fl12,000/1)/2)]. The losses with respect to accrued interest and principal are characterized and sourced under the rules of section 988.

[FR Doc. C1–252 Filed 4–27–01; 8:45 am]

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