

Index Numbers: 1221.12-02, 7805.04-00

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

TAM-117130-97

MARCH 31, 1999

CC:DOM:FI&P:B1

Number: **199930001**

Release Date: 7/30/1999

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's EIN:

Tax Years:

Conference held:

LEGEND:

Taxpayer =

a =

B =

T-1 =

T-2 =

T-3 =

T-4 =

T-5 =

T-6 =

T-7 =

T-8 =

T-9 =

T-10 =

T-11=

Company =

ISSUES

Is the gain or loss from the termination of Taxpayer's liability hedging transactions ordinary or capital in character? Should Taxpayer be granted relief under § 7805(b) of the Internal Revenue Code from the retroactive application of the character rules of § 1.1221-2 of the Income Tax Regulations?

CONCLUSIONS

The gain or loss from the termination of Taxpayer's liability hedging transactions is ordinary. Section 7805(b) relief from the retroactive application of the character rules of § 1.1221-2 is granted for transactions T-1, T-2, T-3, T-4, T-5, T-6, T-7, T-8, T-9, and T-10. Section 7805(b) relief is not granted for transaction T-11.

FACTS

On June 18, 1990, Taxpayer, a calendar year taxpayer, entered into 3 liability hedging transactions in the form of interest rate swaps, T-1, T-2, and T-3.

On February 27, 1991, Taxpayer entered into a liability hedging transaction in the form of an interest rate cap, T-4. In August 1991, Taxpayer entered into 3 liability hedging transactions in the form of interest rate swaps, T-5, T-6, and T-7. On November 19, 1991, Taxpayer entered into 2 liability hedging transactions in the form of interest rate swaps, T-8 and T-9.

On September 22, 1992, Taxpayer entered into a liability hedging transaction, T-10.

The facts submitted state that all of these liability hedging transactions were entered into in the normal course of Taxpayer's trade or business primarily to reduce the risk of interest rate fluctuations with respect to borrowings made by Taxpayer.

In December 1992, Taxpayer terminated a portion of T-4.

Between February 24, 1993, and September 16, 1993, Taxpayer terminated 11 of these liability hedge positions and recognized gain on each position for a total gain of \$a.

On October 18, 1993, Taxpayer entered into a liability hedging transaction in the form of a swaption, T-11. The facts submitted state that this hedge was entered into in the normal course of its trade or business primarily to reduce the risk of interest rate fluctuations with respect to borrowings made by Taxpayer.

In December 1993, Taxpayer terminated T-11, which resulted in a loss.

Taxpayer terminated T-1 through T-10 after July 1992 and before October 20, 1993, the date the temporary and proposed regulations under § 1.1221-2 were published.

LAW AND ANALYSIS

Section 1221 defines the term capital asset as property held by the taxpayer (whether or not connected with his trade or business) and then excludes the following five specific classes of property from capital asset status: (1) property of a kind which would properly be included in the inventory of the taxpayer; (2) real property or other depreciable property used in the taxpayer's trade or business; (3) a copyright, a literary, musical, or artistic composition, or similar property held by the taxpayer who created it; (4) accounts or notes receivable acquired in the ordinary course of the taxpayer's trade or business for services rendered or from the sale of inventory; and (5) a publication of the United States Government.

Section 1.1221-2(a)(1) provides that § 1.1221-2 governs the treatment of hedging transactions. Section 1.1221-2(a)(1) states generally that the term capital asset does not include property that is part of a hedging transaction (as defined in § 1.1221-2(b)).

Section 1.1221-2(b) defines a hedging transaction to include a transaction that a taxpayer enters into in the normal course of its business primarily to reduce the risk of interest rate

changes with respect to borrowings made or to be made by the taxpayer. Whether hedges of a taxpayer's debt issuances (borrowings) are hedging transactions is determined without regard to the use of the proceeds of the borrowings. Section 1.1221-2(c)(6).

Based on the facts submitted that Taxpayer entered into T-1 through T-11 in the normal course of its trade or business primarily to reduce the interest rate risk with respect to its borrowings, T-1 through T-11 were hedging transactions within the meaning of § 1.1221-2(b). Thus, the character of the gain or loss on the termination of the transactions is controlled by § 1.1221-2(a)(1). The liability hedging termination gains or losses are ordinary in character.

Taxpayer requests relief under § 7805(b) from the retroactive application of the character rules of § 1.1221-2 for the liability hedges it terminated.

Based on the facts submitted, including information in Taxpayer's records and the Service's administrative practice, Taxpayer's request for relief under § 7805(b) from the retroactive application of the character rules of § 1.1221-2 is granted for the gain realized on the terminations of T-1 through T-10, which occurred prior to the issuance of the temporary and proposed character rules of § 1.1221-2. Relief is not granted and § 1.1221-2(a)(1) applies to the termination of T-11.

A copy of this technical advice memorandum is to be given to Taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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