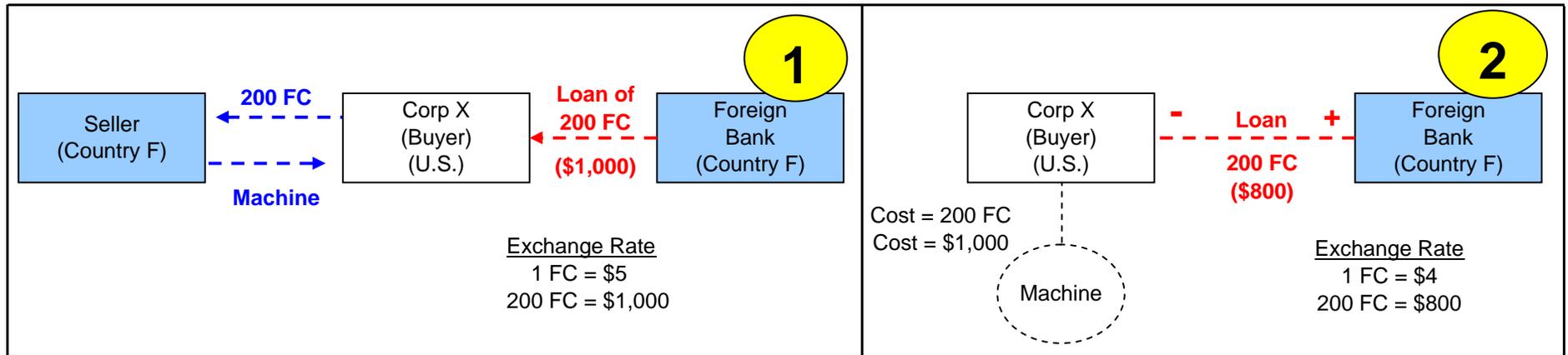


Purchase in Non-Functional Currency

After Currency Devaluation



X, a United States corporation, operates an equipment rental business in foreign country F. On January 10, 1974, X borrowed 200 units of F currency from a bank in country F and used that amount to pay for a machine needed for delivery to a customer, in accordance with a recently signed long term agreement for the rental of such machine. On January 10, 1974, one unit of F currency was worth five United States dollars on the foreign exchange market. On January 15, 1974, the rental agreement became effective and the machine was delivered by X to its customer. On the following day F devalued its currency by twenty percent. X's agreement with the bank required that X repay the loan (200 units of F currency) in five annual installments of 40 units of F currency each plus interest. The issues in the ruling were whether the basis for the machine was 1,000 dollars, the equivalent in United States dollars of the 200 units of F currency paid for the machine; whether X will have gain from the repayment of the bank loan in devalued F currency; and whether such gain, if any, is ordinary income or capital gain.

X should record on its books and records as the basis of the machine the entire purchase price paid in United States dollars, and thereafter make no adjustment to the basis of the machine for the purpose of reflecting fluctuations in the United States dollar value of the F currency borrowed to purchase the machine. To determine gain when selling the machine X should express the cost and selling price at the exchange rate prevailing on the purchase and sale dates, respectively. See Rev. Rul. 54-105. Also, X will realize ordinary gain or loss on each annual payment to the bank equal to the difference, if any, between the original United States dollar value of that portion of the loan principal which is discharged and the United States dollar value of the F currency used to make the repayment on the date such payments is made. This ruling pre-dates the enactment of sections 985, 987 and 988. If a "qualified business unit" (QBU) exists in Country F, then separate rules apply.