

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

Telephone Number:

Refer Reply To:
CC:INTL:BR5
PLR-106573-05

Date:
July 19, 2005

In Re:

LEGEND

Company

Year Y
AA

BB

CC

D
E
F

Dear :

This is in response to your letter dated January 28, 2005 in which you request a ruling granting Company consent for a change in its spot rate convention for payables and receivables that are denominated in nonfunctional currency and relate to goods and services bought and sold in the ordinary course of business, under Treas. Reg. § 1.988-1(d)(3). Company also requests a ruling that a proposed new average exchange rate used to translate accrued interest income and expense under Treas. Reg. § 1.988-2(b)(2)(ii)(C) is an acceptable average exchange rate under Treas. Reg. § 1.988-2(b)(2)(iii).

FACTS:

Company, a domestic corporation, is filing this ruling on behalf of itself and all of its affiliates that maintain their books and records on Company's systems. Company was incorporated in Year Y. The business segments of Company are AA. Company has BB products and CC services. Company has operations in D countries.

Company's businesses enter into approximately E nonfunctional currency transactions totaling over \$F. For purposes of accruing income and deductions in a nonfunctional currency, Company uses a single exchange rate for currency throughout each calendar month, which is referred to as the . The must be determined prior to the beginning of the month in order to permit timely updating of automated accounting systems.

In order to increase the accuracy of Company's exchange rate, Company plans to change the exchange rate convention that it uses to accrue nonfunctional currency items of income and expense for financial accounting purposes. Company is requesting permission to change the exchange rate it uses to accrue nonfunctional currency items of income and expense for U.S. tax purposes to match the method that Company plans to use for financial accounting purposes.

Currently, Company calculates the by using a "30-day trailing rate," which is the average of daily spot rates from all business days from the 15th day of the second preceding prior month to the 15th day of the first preceding prior month (the "Current Rate").

Under the proposed method, Company will calculate the using the average of the spot rate and the 30-day forward rate of the next-to-last Thursday of the preceding fiscal month (the "Proposed Rate"). For purposes of calculating the Proposed Rate, the spot rate will be obtained from market information and data service (e.g. Reuters) and the 30-day forward rate will be determined in the following manner:

- 1) If there is a liquid forward market for the currency, the 30-day forward rate will be obtained from the market information and data service;

- 2) If the currency has poor liquidity in the forward market, the 30-day forward rate will be determined by using the 30-day interest rate for that currency and the U.S. dollar, which will come from the market information and data service; and
- 3) If a currency is pegged to the U.S. dollar, the 30-day forward rate is equal to the pegged rate.

LAW & ANALYSIS:

Treas. Reg. § 1.988-1(d)(3) provides that if consistent with the taxpayer's financial accounting, a taxpayer may utilize a spot rate convention determined at intervals of one quarter year or less for purposes of computing exchange gain or loss with respect to payables and receivables denominated in a nonfunctional currency that are incurred in the ordinary course of business with respect to the acquisition or sale of goods or the obtaining or performance of services. Treas. Reg. § 1.988-1(d)(3) further provides that the use of a spot rate convention cannot be changed without the consent of the Commissioner.

Treas. Reg. § 1.988-2(b)(2) provides rules regarding the translation of nonfunctional currency interest income or expense received or paid with respect to a debt instrument described in Treas. Reg. § 1.988-1(a)(1)(ii) and Treas. Reg. § 1.988-1(a)(2)(i) for which all payments are denominated in, or determined with reference to, a single nonfunctional currency. Treas. Reg. § 1.988-2(b)(2)(i).

Treas. Reg. § 1.988-2(b)(2)(ii)(C) provides that with respect to an instrument described in Treas. Reg. § 1.988-2(b)(2)(i), interest income or expense that is required to be accrued prior to receipt or payment (e.g., under section 1272, 1281, or 163(e) or because the taxpayer uses an accrual method of accounting) shall be translated at the average rate (or other rate specified in Treas. Reg. § 1.988-2(b)(2)(iii)(B)) for the interest accrual period or, with respect to an interest accrual period that spans two taxable years, at the average rate (or other rate specified in Treas. Reg. § 1.988-2(b)(2)(iii)(B)) for the partial period within the taxable year.

Treas. Reg. § 1.988-2(b)(2)(iii)(A) provides that for purposes of Treas. Reg. § 1.988-2(b), the average rate for an accrual period (or partial period) shall be a simple average of the spot exchange rates for each business day of such period or other average exchange rate for the period reasonably derived and consistently applied by the taxpayer.

Treas. Reg. § 1.988-2(b)(2)(iii)(B) provides that for taxable years beginning after March 17, 1992, a taxpayer may elect to translate interest income and expense at the spot rate on the last day of the interest accrual period (and in the case of a partial accrual period, the spot rate on the last day of the taxable year). Treas. Reg. § 1.988-2(b)(2)(iii)(B) further provides that a method so elected must be applied consistently to all debt

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instruments from year to year and cannot be changed without the consent of the Commissioner.

The Proposed Rate, which will be calculated using published rate information, will be used by Company for both financial accounting purposes and U.S. tax purposes provided the requested rulings are granted.

Based solely on the facts and representations submitted, Company may change its spot rate convention under Treas. Reg. § 1.988-1(d)(3) to the Proposed Rate, as described above, and use of the Proposed Rate to determine an average rate for an accrual period (or partial period) will be considered as reasonably derived for purposes of Treas. Reg. § 1.988-2(b)(2)(iii).

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the representatives below.

Sincerely,

Jeffrey L. Dorfman
Chief, Branch 5 Associate Chief
Counsel (International)

CC: