



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE LEGAL ADVICE

MEMORANDUM FOR WILLIAM BISSELL  
SENIOR ATTORNEY LARGE & MIDSIZE BUSINESS

FROM: Jeffrey Dorfman  
Chief, Branch 5, Office of Associate Chief Counsel  
(International)

SUBJECT:

This Chief Counsel Advice responds to your memorandum dated June 4, 2002. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Parent =  
Taxpayer =  
FSub =  
Country A =  
Currency A =  
Number R =  
Amount A =  
Amount B =  
Amount C =  
Rate X =  
Rate Y =  
Date 1 =  
Date 2 =  
Date 3 =  
Date 4 =  
Date 5 =

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## ISSUE

Whether Taxpayer's United States dollar basis of FSub shares acquired from Country A shareholders in a tax-free reorganization described in section 368(a)(1)(B) must be determined with reference to the United States dollar/Currency A exchange rates in effect on the dates on which the Country A shareholders acquired their FSub shares in section 351 nonrecognition transactions, or with reference to the exchange rates in effect on the date of the tax-free reorganization when Taxpayer acquired the FSub shares from the Country A shareholders.

## CONCLUSION

Taxpayer's United States dollar basis of the FSub shares it acquired from the Country A shareholders must be determined with reference to the United States dollar/Currency A exchange rates in effect on the dates on which the Country A shareholders acquired their FSub shares.

## FACTS

During all relevant time periods, Taxpayer was a United States corporation and a wholly-owned subsidiary of Parent, also a United States corporation. Taxpayer's functional currency was the United States dollar. On Date 1, Taxpayer and R investors, who were residents of Country A, formed FSub, a corporation organized pursuant to the laws of Country A.

In connection with the formation of FSub, Taxpayer and the R Country A investors each contributed Currency A to FSub in exchange for FSub stock in a section 351 transaction in which no gain or loss was recognized. Specifically, on Date 2, Taxpayer contributed to FSub Currency A then worth Amount A as well as property located in Country A then worth Amount B. Taxpayer recorded its basis in its FSub stock and kept its books in United States dollars. Also on Date 2, the R Country A investors contributed to FSub Currency A then worth a total of Amount A. On Date 2, the exchange rate with respect to the United States dollar was Rate X. From Date 3 through Date 4, both Taxpayer and the R Country A shareholders made additional capital contributions to FSub, in each case in exchange for additional FSub stock. We assume for purposes of the analysis set forth herein that these additional capital contributions also qualified as section 351 transactions in which no gain or loss was recognized.

On Date 5, Taxpayer acquired all of the FSub stock held by the R Country A shareholders in exchange for Taxpayer's voting common stock worth Amount C in a reorganization transaction described in section 368(a)(1)(B). We assume for purposes of the analysis set forth herein that this reorganization qualified as a

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nonrecognition transaction. On the date of the reorganization, the Currency A exchange rate with respect to the United States dollar was Rate Y.

### LAW AND ANALYSIS

Generally, United States tax concepts apply to determine the tax consequences of events even if those events occur outside of the United States and even if those events result from activities conducted by foreign persons. United States v. Goodyear Tire and Rubber Co., 493 U.S. 132, 145 (1989), reh'g denied, 493 U.S. 1095 (1990); Biddle v. Commissioner, 302 U.S. 573, 578 (1938). See also Untermeyer v. Commissioner, 59 F.2d 1004, 1005 (2nd Cir. 1932), cert. denied, 287 U.S. 647 (1932); Rev. Rul. 73-254, 1973-1 C.B. 613; Rev. Rul. 64-158, 1964-1 C.B. (Part 1) 140. This controlling aspect of United States tax concepts similarly applies to determinations of basis for property acquired by foreign persons outside the United States. See, e.g. Reisner v. Commissioner, 34 T.C. 1122 (1960), acq., 1961-2 C.B. 5.

Section 1011(a) provides that the adjusted basis of for determining gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis of such property determined under section 1012 or other applicable provisions of the Code, including subchapter C, adjusted as provided in section 1016.

Under section 358(a)(1), in the case of a section 351 exchange in which no gain or loss is recognized, the basis of the property permitted to be received under such section without the recognition of gain or loss is generally the same as that of the property exchanged.

Under section 362(b), if property is acquired by a corporation in connection with a tax-free reorganization, the recipient's basis in such property is generally the same as it would be in the hands of the transferor, increased in the amount of gain, if any, recognized to the transferor on such transfer. Thus, in the case of stock received in a reorganization described in section 368(a)(1)(B) in which no gain is recognized, the recipient's basis in such stock is equal to its basis in the hands of the transferors immediately before the transaction.

Rev. Rul. 78-281, 1978-2 C.B. 204, provides that the basis of property purchased by a U.S. corporation with foreign currency borrowed from a foreign bank must be determined by reference to the exchange rate in effect on the date of purchase, and that the basis of the purchased property cannot be adjusted for the purpose of reflecting subsequent fluctuations in the United States dollar value of the borrowed foreign currency.

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Rev. Rul. 54-105, 1954-1 C.B. 12, states that for purposes of determining gain, the basis and selling price of property acquired by a U.S. citizen living in a foreign country should be expressed in United States dollars at the rates of exchange prevailing as of the dates of purchase and sale of the property, respectively.

In a series of cases decided under section 127(a) of the 1939 Code, the appropriate method for determining the amount of the deduction for losses resulting from the destruction or seizure of property during war was addressed. These cases involve foreign property purchased (or inherited) by a nonresident alien with foreign currency. For example, in Heckett v. Commissioner, 8 T.C. 841, 847 n.6 (1947), acq. C.B. 1947-2, 2, the court stated that the taxpayer would have to translate the cost basis of property acquired with foreign currency into United States dollars at the exchange rate in effect at the time of purchase. Similarly, in Abraham v. Commissioner, 9 T.C. 222, 226 (1947), acq. in part and nonacq. in part C.B. 1948-1, 1, 4, the court applied the exchange rate in effect at the time of purchase in determining the United States dollar basis of property acquired with foreign currency. In Gutwirth v. Commissioner, 40 T.C. 666 (1963), acq. C.B. 1966-2, 5, the taxpayer transferred assets acquired with foreign currency to a New York law firm. The court stated that because the basis of each transferred asset was not converted into United States dollars using the rate of exchange in effect at the time the property was originally acquired or constructed, the figures reflected on the books of the law firm did not represent the true cost of the assets in United States dollars. See also Ternovsky v. Commissioner, 66 T.C. 695 (1976); Elek v. Commissioner, 30 T.C. 731 (1958); Daniel v. Commissioner, 19 T.C.M. (C.C.H.) 1521 (1960).

Recently, in Travelers Ins. Co. v. United States, 2002 U.S. App. LEXIS 19056 (Fed. Cir. 2002), the Federal Circuit Court of Appeals addressed the basis translation issue in the context of former section 805. Under former section 805(b)(4)(B), the amount attributable to an asset for purposes of determining the adjusted reserves and earnings rates of a life insurance company was its adjusted basis. The government argued that former section 805(b)(4)(B) dictated that the taxpayer use historical exchange rates to translate the adjusted basis of certain Canadian dollar denominated bonds, mortgages, and other assets into United States dollars. The court held that although the language of section 805 did not dictate the use of historical exchange rates, “the IRS could properly, as an exercise of discretion, require use of historical exchange rates . . .” Id., 2002 U.S. App. LEXIS at 33.

In the present case, Taxpayer acquired FSub shares from R Country A shareholders in a reorganization described in section 368(a)(1)(B) in which no gain was recognized. Accordingly, under section 362(b), Taxpayer’s basis in such stock is equal to its basis in the hands of the R Country A shareholders immediately

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before the transaction. The R Country A investors made contributions of Currency A to FSub in exchange for FSub stock in section 351 transactions in which no gain or loss was recognized. Even though these events occurred outside of the United States and resulted from activities conducted by foreign persons, United States tax concepts must be applied in determining the basis of the FSub stock acquired by the Country A investors. Accordingly, the basis of the FSub stock originally held by the R Country A investors must be determined under section 358(a)(1).

Under section 358(a)(1), in the case of a section 351 exchange in which no gain or loss is recognized, the basis of the property permitted to be received without the recognition of gain or loss is generally the same as that of the property exchanged. The Currency A basis of the Country A investors in their FSub shares will thus be equal to the amount of Currency A contributed. Given the rulings and cases set forth above, we believe that absent specific administrative guidance to the contrary, the exchange rates required to be used to determine the United States dollar basis in their FSub shares are the respective exchange rates on the dates that the Country A investors originally acquired such shares. On Date 2, the date on which the Country A investors contributed Currency A worth a total of Amount A to FSub in exchange for FSub stock, the exchange rate was Rate X. Accordingly, Rate X must be used to translate the Amount A of Currency A into United States dollars. In the case of each additional contribution of Currency A by the Country A investors to FSub, the exchange rate on the date of each such contribution must be used to translate the amount of Currency A contributed to FSub on that date into United States dollars. Rate Y, the exchange rate in effect on Date 5, the date of the reorganization, is not to be taken into account.

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Please call if you have any further questions.

Jeffrey Dorfman

By: \_\_\_\_\_  
JEFFREY DORFMAN  
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