ID: CCA_2010061410584017

Office:

UILC: 446.33-00

Number: **201028039**
Release Date: 7/16/2010

From:
Sent: Monday, June 14, 2010 10:58:45 AM
To:
Cc:
Subject: Hedge Accounting For Floating-To-Fixed Swap

This responds to your inquiry regarding Taxpayer's claim that it can deduct the loss it incurred in the year that it terminated a notional principal contract that hedged its interest rate risk on issued floating rate debt. The notional principal contract hedged the entire term of the floating rate debt. Taxpayer's issued debt remains outstanding. Although Taxpayer apparently concedes that the section 1.446-4 hedge timing rules govern, it has suggested that gain or loss on a hedge of floating rate debt is not required to be spread over the period to which the hedge is related. Taxpayer asserts that its accounting treatment is not governed by Rev. Rul. 2002-71 or the principles stated therein.

Whether or not Rev. Rul. 2002-71 directly bears on the treatment of the floating-to-fixed swaps in this case, the revenue ruling is illustrative of broader matching principles that are specifically set forth in the hedge timing regulation and bear directly on the matter here. Section 1.446-4 provides that taxpayers must clearly reflect income on hedging transactions by reasonably matching income, deduction, gain, or loss from a hedging transaction with the timing of income, deduction, gain or loss from the item or items hedged. Section 1.446-4(e)(4) contains more particular guidance for hedges of debt instruments. It states that gain or loss from a transaction that hedges a debt instrument issued or to be issued must be accounted for by reference to the terms of the debt instrument and the period or periods to which the hedge relates. The regulation goes on to make it clear that this principle applies whether or not the issued debt is fixed or floating in nature. It states, "A hedge of an instrument that provides for interest to be paid at a fixed rate or a qualified floating rate, for example, generally is accounted for using constant yield principles. Thus, assuming that a fixed rate or qualified floating rate instrument remains outstanding, hedging gain or loss is taken into account in the same periods it would be taken into account if it adjusted the yield of the instrument over the term to which the hedge relates."

Thus, in the instant case, we agree with you that hedging gain or loss on the floating-to-fixed swap is spread over the life of the variable rate debt that the swap served to hedge.

No opinion is expressed on any matter not specifically addressed herein.

Please do not hesitate to call if you have any further questions.