

MEMO# 11829

April 20, 2000

INSTITUTE COMMENTS ON PROPOSED REGULATIONS DEFINING HYPERINFLATIONARY CURRENCY FOR PURPOSES OF SECTION 988

1 Under Treas. Reg. 1.988-2(b)(15), currency gain or loss on debt instruments (and demand deposits) issued or acquired when the denomination currency was hyperinflationary must be realized annually under a mark-to-market methodology. Similar rules apply to certain hyperinflationary contracts (such as forwards, futures and options) and currency swaps and other notional principal contracts. [11829] April 20, 2000 TO: TAX COMMITTEE No. 19-00 RE: INSTITUTE COMMENTS ON PROPOSED REGULATIONS DEFINING HYPERINFLATIONARY CURRENCY FOR PURPOSES OF SECTION 988

The Institute has submitted the attached comment letter to the Internal Revenue Service in response to proposed regulations that would change the base period to be considered when determining whether a currency is hyperinflationary for purposes of computing foreign currency gains or losses under section 988. To determine whether a currency is hyperinflationary under existing rules, a taxpayer looks at the cumulative effects of inflation over the thirty-six calendar month period immediately preceding the first day of the current calendar year. The base measurement period, as proposed, would consider the cumulative effects of inflation over the thirty-six calendar month period ending on the last day of the taxpayer's current taxable year.¹ The Institute's letter recommends that regulated investment companies ("RICs") remain subject to the existing calendar-year base measurement period for determining whether a currency is hyperinflationary. This recommendation is based on the interaction of the hyperinflationary currency rules and the "minimum distribution excise tax" rules to which RICs are subject. Specifically, the letter: ! describes generally the distribution requirements to which RICs are subject for income and excise tax purposes; ! describes generally the income and excise tax rules applicable to a RIC's determination of hyperinflationary currency gains or losses; ! describes the delayed availability of country-specific inflation data; ! explains that for excise tax purposes a RIC generally is required to mark to market foreign currency gain or loss under the hyperinflationary currency rules on October 31 of each calendar year, irrespective of the RIC's taxable year; ! explains that under the proposed change in the base measurement period, a RIC generally would not know whether a denomination currency for a debt security or other financial instrument was hyperinflationary on October 31 (or even sufficiently in advance of the end of the calendar year) to compute and make its required excise tax distribution for that calendar year; and ! recommends that the final regulations defining hyperinflationary currency for purposes of section 988 retain the thirty-six calendar

month period immediately preceding the current calendar year as the base period for RICs.
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