REPORT # 594

TAX SECTION

New York State Bar Association

Report on Developing Country Debt-Equity Swaps

December 1, 1988

Table of Contents

TAX SECTION
New York State Bar Association

December 2, 1988

Debt-Equity Swaps

Dear Larry:

Enclosed is a Report on Developing Country Debt-Equity Swaps, prepared by John A. Corry and William L. Burke. The Report considers the conclusions reached in Revenue Ruling 87-124 and generally supports those conclusions with respect to all three situations considered in the Ruling. It questions, however, whether the facts support the possibility of a taxable gain to in the first situation addressed in the Ruling. It also identifies various alternative ways to analyze the situations addressed in the Ruling, including rationalizing the tax results by treating some of the LCs transferred to the foreign entity ("FX" or "Z") as a non-shareholder subsidy from the foreign government directly to FX or Z.

Finally, the Report notes two issues not addressed in the Ruling on which the Service should consider issuing guidance. One of those is the further collateral consequences to the foreign entity that receives the LCs, and the other is the reference point to use for the "free market" exchange rate to the extent that rate is treated as relevant.

Sincerely,

Herbert L. Camp

The Honorable Lawrence B. Gibbs,
Commissioner of Internal Revenue,
Internal Revenue Service,
1111 Constitution Avenue, N.W.,
Washington, D.C. 20224

Encl.

Copies w/encl. to The Honorable O. Donaldson Chapoton,
Assistant Secretary of the Treasury
for Tax Policy,
U. S. Treasury Department,
1500 Pennsylvania Avenue, N.W.,
Washington, D.C. 20220

Leonard B. Terr, Esq.,
International Tax Counsel,
U. S. Treasury Department,
1500 Pennsylvania Avenue, N.W.,
Washington, D.C. 20220

William F. Nelson, Esq.,
Chief Counsel,
Internal Revenue Service,
1111 Constitution Avenue, N.W.,
Washington, D.C. 20224

D. Kevin Dolan, Esq.,
Associate Chief Counsel, Technical,
Internal Revenue Service,
1111 Constitution Avenue, N.W.,
Washington, D.C. 20224

Charles Triplett, Esq.,
Deputy Associate Chief Counsel,
(International),
Internal Revenue Service,
1111 Constitution Avenue, N.W.,
Washington, D.C. 20224

Tax Report #594

NEW YORK STATE BAR ASSOCIATION

TAX SECTION

Report on Developing Country Debt-Equity Swaps

December 1, 1988

NEW YORK STATE BAR ASSOCIATION

TAX SECTION

REPORT ON DEVELOPING COUNTRY DEBT-EQUITY SWAPS

December 2, 1988

This report[1] considers the Federal income tax consequences of transactions ("debt-equity swaps") in which debt obligations of developing countries are retired in exchange for local currency delivered to a local corporation owned by the creditor or its vendee or to a charity selected by the creditor, and comments on the conclusions reached by the Internal Revenue Service in a recent published ruling on the subject.

Rev. Rul. 87-124

In Rev. Rul. 87-124, 1987-47 I.R.B. 5, the Internal Revenue Service considered three different situations. In each situation, X, a U.S. commercial bank, holds a U.S. dollar denominated obligation (the "Obligation") of a foreign country ("FC") central bank of issue evidencing a loan that X has made to the central bank. X's basis in the Obligation is $100, and the

[1] This report was prepared by John A. Corry and William L. Burke. Helpful comments were received from Herbert L. Camp, Peter C. Canellos, Elizabeth Kessenides, Charles M. Morgan, III, Richard C. Pugh, Willard B. Taylor and David E. Watts.

"free market exchange rate" for LCs, the foreign country's currency, is LC100=US$1. An Obligation is transferable, but not to an FC entity, because under FC law, an FC entity cannot hold an Obligation.

The foreign country has a program (the "Program") to convert foreign-held dollar-denominated debt of the central bank into LCs for local investment or other approved uses of the funds in a manner designed to achieve a net long-term infusion of the funds into the local economy.[2] In a prearranged plan as part of the Program, one of the following occurs.

In Situation 1, X sells the Obligation to an unrelated U.S. corporation ("Y") for $60, which the ruling states is the fair market value of similar indebtedness of obligors of FC in the secondary market outside FC. Immediately thereafter, X, on behalf of Y, delivers the Obligation to the central bank, and the central bank credits 900 LCs to an account of FX, a corporation

[2] In an April 18, 1988 letter to Senator Chafee of Rhode Island (the “Steuerle letter”), Treasury Department Deputy Assistant Secretary for Tax Analysis, C. Eugene Steuerle, stated that the principles underlying Rev. Rul. 87-124 would be equally applicable if the Obligation were that of an entity other than a foreign central bank and that the issuance of bonds rather than payment of local currency in exchange for the Obligation, presumably by the central bank, would also not be inconsistent with those principles. The Steuerle letter added, however, that the bonds would have to differ sufficiently from the Obligation for the transaction to be one in which gain or loss would be recognized.

which is organized in FC and which issues all of its stock to Y.[3]

Situation 2 is the same as Situation 1 except that, instead of selling the Obligation to Y for $60, X delivers it to the central bank, which credits FX's account with 900 LCs, with FX issuing all its capital stock to X.

In Situation 3, X delivers the Obligation to the central bank, which credits 900 LCs to an account in the foreign country of Z, a charitable organization incorporated in the United States, for use only in FC for charitable purposes meeting the requirements of Section 170 of the Internal Revenue Code (the "Code").

Rev. Rul. 87-124 separates each situation into independent transactions and then makes determinations based on such separations. In Situation l, X is treated as having a $40 loss from a sale of the Obligation to Y. Y in turn is treated as having redeemed the Obligation for the restricted 900 LCs and recognizes gain or loss equal to the difference between its $60 basis and the value of the restricted 900 LCs. Y's basis in the stock of FX is equal to the value of the restricted 900 LCs.

In Situation 2, X is treated as having sold the Obligation for the restricted 900 LCs, and recognizes loss

[3] Prior to entering into these transactions, all the parties thereto were unrelated.

equal to the difference between its $100 basis in the Obligation and the value of the restricted 900 LCs. X's basis in the stock of FX is equal to the value of the restricted 900 LCs. Situations 1 and 2 thus are similar except that X would have a greater loss in situation 1 (and Y a corresponding gain) to the extent that the value of the restricted 900 LCs was more than $60.

In Situation 3, X is treated as having sold the Obligation for the restricted 900 LCs, so as to have the same gain or loss as in Situation 2. X is then treated as having made a potentially deductible charitable contribution to Z in the amount of the value of the restricted 900 LCs.

The Ruling does not address the consequences to FX in Situations 1 or 2, or to Z in Situation 3.

SUMMARY OF COMMENTS

The ultimate commercial result in each situation is essentially the same. X has disposed of the Obligation and either FX or Z has received an appropriate number of LCs with restriction on use. Characterizing the situations as a series of separate steps can result in different tax consequences, however, depending upon how the steps are visualized. Because the transactions in fact occur as an integrated whole and the effective substance is the same in each case, we believe that the three situations should be analyzed with a consistent characterization. We endorse the conclusion in the Ruling of a net current recognized loss to X in all three situations and a

further potential charitable contribution by X in Situation 3. We question, however, whether the facts in Situation 1 support the possibility of a taxable gain to Y. While not considered in the Ruling and similarly beyond the primary focus of this Report, attention also needs to be given to the appropriate collateral consequences to FX and Z from their receipt or use of the restricted LCs and, to the extent relevant, what reference point to use for the "free market" exchange rate.

Situation 1

We concur in the conclusion of the Ruling that X has a recognized loss of $40, the difference between its $100 basis in the Obligation and the $60 it receives in the transaction. We question, however, the Ruling's conclusion that Y has a gain to the extent that the value of the restricted 900 LCs received by FX is more than $60.

Situation 1 may be analyzed in various ways, depending on whether X, Y or FX is considered to redeem the Obligation and whether dollars, LCs or the Obligation are considered to be contributed to FX. Among the alternatives are the following:

(1) Y bought the Obligation from X; Y redeemed the Obligation for 900 LCs; and Y contributed the 900 LCs to FX;

(2) Y bought the Obligation from X; Y contributed the Obligation to FX; and FX redeemed the Obligation for 900 LCs;

(3) Y contributed $60 to FX; FX bought the Obligation from X; and FX redeemed the Obligation for 9 00 LCs;

(4) X redeemed the Obligation for 900 LCs; X sold the 900 LCs to Y for $60; and Y contributed the 900 LCs to FX; and

(5) X redeemed the Obligation for 900 LCs; Y contributed $60 to FX; and FX bought 900 LCs from X for $60.

As to each of the above, there is a further variation of treating the Obligation as redeemed for less than 900 LCs, with the difference contributed by FC to FX as a subsidy, or non-shareholder contribution.

The Ruling adopts the first alternative: Y is treated as purchasing the Obligation from X, then exchanging it for 900 LCs that it uses to acquire the stock of FX. We believe that the correct analysis is the fifth (or the fifth as modified to treat some of the LCs as contributed by FC to FX as a subsidy).

We acknowledge that if Y is treated as purchasing the Obligation (or the appropriate number of LCs), Y could have at least one exchange on which at least gain would be recognized. If, as the Ruling postulates, Y purchases the Obligation and then receives payment from the central bank, it could have a gain or loss from that transaction. Y will also be treated as having taxable gain (but not loss) on any transfer by it to FX of either

LCs (whether from X or from the central bank) or the Obligation (alternatives 1, 2 and 4).[4] We question, however, whether Y should be regarded as ever acquiring either the Obligation or the LCs. And even if Y is treated as acquiring the Obligation or the LCs, we question whether Y should be treated as having the possibility of a further gain or loss on their disposition.

Although the Ruling postulates that Y acquires the Obligation, in fact Y may never acquire legal or beneficial title to either the Obligation or any of the LCs. We understand that many if not most debt-equity swaps are effected pursuant to foreign governmental programs that are in large part intended to induce U.S. and other foreign shareholders of existing local subsidiaries to invest additional equity in those subsidiaries. We understand also that the investments are usually targeted by the local government -- for example, priority is given to businesses that contribute to exports and the subsidiary's use of the funds generated by the swap is restricted accordingly.

---

[4] Foreign currency and the Obligation both are treated as property for tax purposes. Since FX is a foreign corporation, the exchange of either foreign currency or the Obligation for its stock constitutes a realization event and, pursuant to Section 367(a), the non-recognition rules of Section 351 will not apply as they would if FX were a domestic corporation.

Y presumably has no interest in acquiring the Obligation as an investment, but only seeks to permit FX to obtain LCs at a favorable dollar cost. Indeed, the disposition of the Obligation by X, the surrender of the Obligation to the foreign government and all the other steps are locked in by signed agreements so that neither the Obligation nor the LCs can come to rest in Y. As a matter of form as well as substance, Y never acquires the Obligation or any of the LCs or any ownership rights to either. Accordingly, neither the first, second nor fourth alternatives should be adopted. Likewise, the third alternative (involving FX acquiring the Obligation) seems unrealistic since ownership by FX is contrary to FC law.[5] Therefore, the transaction should be treated under the fifth alternative, as though Y had invested dollars (that will be used to procure a benefit for FX) against receipt by Y of all of the stock of FX (or as a contribution of the dollars to the capital of FX if Y already owned all the stock of FX). Viewed in this manner, the value of the LCs that are credited to FX's account with the central bank is irrelevant insofar as Y is concerned because Y has made only a $60 investment in the stock of FX.

---

[5] Compare Commissioner v. First Security Bank of Utah, 405 U.S. 394 (1972) (Section 482 allocation of insurance income to affiliate improper where affiliate prohibited by banking law from acting as insurance agent and receiving insurance income).

Even if Rev. Rul. 87-124 is correct in concluding that Y acquired the Obligation, we question whether the ruling is correct in suggesting that Y may have gain to report on the transaction.[6] The transactions occur simultaneously, so that there is no realistic possibility that the Obligation has fluctuated in value between the time that Y purchased the Obligation and the time it receives the FX stock. According to Rev. Rul. 87-124, the $60 that Y paid for the Obligation was the fair market value of similar indebtedness and, since Y and X were unrelated, presumably this also was the Obligation's fair market value. To say that Y may have a gain in such circumstances stretches reality. We believe that the better view is that, even if Y is deemed to transfer the Obligation or the 900 LCs, the value thereof should equal Y's cost basis, so that it should not have any gain or loss.

Although the LCs had a free market value of $90, the ruling recognizes that this must be discounted because of the limitations on the LCs' use. Under these circumstances, it seems appropriate to apply the principle of Philadelphia Park

[6] The Ruling states in two places that Y has a gain on the exchange of the Obligation for the LCs to the extent that the fair market value of the LCs exceeds the $60 that Y has paid for the Obligation. In another place, it also refers to the gain “if any”. Although the Ruling refers only to gain, the disposition of the Obligation in a taxable exchange theoretically could produce a recognized loss as well as a recognized gain. The transfer of LCs from Y to FX, by contrast, would result in recognition of only gain under the gain-only limitation of Section 367.

Amusement Co. v. United States. 126 F. Supp. 184 (Ct. C1. 1954), that where the fair market value of property received on one side of an exchange is unascertainable, the property transferred on the other side should be treated as having the same fair market value. Here, under this principle, the $60 paid to X fixes the value of the property surrendered.

As mentioned above, another approach would be to focus on the appropriate number of LCs that should be treated as received for the Obligation. Under this characterization, part of the LCs would be treated as a subsidy from the foreign government paid directly to FX.[7] The remaining LCs - an amount equal to the market value of the Obligation at "free market" rates - would be treated as paid in satisfaction of the Obligation. While the choice of characterizations would potentially affect the collateral tax consequences to FX, the result again would be no gain or loss to Y.

Situation 2

As in Situation 1, X has clearly realized a loss from the disposition of the Obligation. X, unlike Y in Situation 1, is the historic owner of the Obligation. The critical questions thus are whether X's loss is recognized and if so what is the amount of the loss.

[7] The restrictions on use of the LCs would be disregarded in valuing the LCs under this approach on the rationale that the restriction is generated by the subsidy for making an investment in the local economy in the manner or area desired by the foreign government.

In Situation 2, there are, however, two alternative characterizations of the transaction:

(1) X redeemed the Obligation for 900 LCs; and X transferred the 900 LCs to FX; or

(2) X transferred the Obligation to FX; and FX redeemed the Obligation for 900 LCs.

In addition, as in Situation 1, in each case there is a further variation of treating part of the LCs as paid to redeem the Obligation and the remainder contributed by FC to FX as a subsidy, or non-shareholder contribution.

The Ruling adopts the first characterization. We agree with that approach, or that approach as modified to treat some of the LCs as contributed as a subsidy.

If the form of the transaction as characterized by the Service is followed, X has a recognized loss because it is treated as receiving LCs in exchange for the Obligation. The fact that the central bank does not pay X directly, but instead pays a third party (FX) in order to facilitate its issuance of stock to X, is irrelevant to an analysis of the transaction. Therefore, like X in Situation 1, X in Situation 2 has in fact a realized and recognized loss on the transaction.

As mentioned, the transaction instead could be viewed as a transfer of the Obligation by X to FX in exchange for FX stock, with FX then transferring the Obligation to the central bank for 900 LCs. In that event, X would, under Section 351, recognize no

loss. Section 367, which applies only to gain transactions, would be inapplicable. We do not believe that this treatment would be appropriate since it is not consistent with the substance of the transaction. X receives stock in FX rather than cash when the transaction is completed, but if FX were viewed as issuing its stock to X in exchange for the Obligation, FX's ownership of the Obligation would be as transitory as Y's nominal ownership in Situation 1, since FX ultimately has received LCs rather than retaining the Obligation. Moreover, under FC law, the Obligation cannot be held by an FC entity, such as FX. Finally, it is well established that a taxpayer cannot shift gain or loss on property to be sold by transferring the property to an affiliate just before sale. See National Securities Corp. v. Commissioner, 137 F.2d 600 (3rd Cir. 1943) (Section 351 does not override the Commissioner's authority under Section 482); Richard H. Foster, 80 T.C. 34, 151-157 (1983), aff'd. 756 F.2d 1430 (9th Cir. 1985), cert. denied. 474 U.S. 1055 (1986); Reg. 1.482-l(d)(5). It would be strange to choose as the correct alternative one which could be attacked under Section 482.

Another possible consequence of the Service's (and our) interpretation of the Situation 2 transaction would be deferral of X's loss under the rationale of the blocked foreign currency rule set forth in Rev. Rul. 74-351, 1974-2 C.B. 144, as modified by Rev. Rul. 81-290, 1981-2 C.B. 108. According to a published

article, an unpublished preliminary draft of Rev. Rul. 87-124 obtained through the Freedom of Information Act stated that in Situation 1, Y could defer the gain that was held to be realized on the exchange of the Obligation for LCs under the rationale of Rev. Rul. 74-351.[8] However, the fact situation considered by the draft apparently included additional FC restrictions that are not referred to in Rev. Rul. 87-124, i.e., Y could not sell its FX stock to any party for ten years and could not receive distributions on the stock for five years. We have already questioned Rev. Rul. 87-124's conclusion that Y could realize taxable gain in Situation 1, and we very much doubt that any taxpayer involved in a Situation 2 transaction would elect to defer loss under Rev. Rul. 74-351 until the FX stock became readily convertible directly or indirectly into U.S. dollars. We therefore support the Ruling not being based upon any blocked currency concept.

Situation 3

Situation 3 raises two important legal questions:

(a) Is the legal analysis of Rev. Rul. 87-124 correct, i.e., did X in fact exchange the obligation for LCs which it then contributed to Z; and

(b) Is X entitled to deduct the contribution to Z?

[8] Dionne, Tax Notes. April 11, 1988, pp. 166-173

A. The Legal Analysis. Like Situation 2, the legal analysis is important because of the different tax consequences that are dependent thereon. If this set of transactions is viewed as a contribution of the Obligation by X instead of an exchange of the Obligation for LCs, X will be entitled under Section 170 to deduct only the Obligation's fair market value, which is presumably lower than its basis.

We believe that the Service correctly analyzed this transaction in treating X as recognizing a loss on the disposition of the Obligation followed by a charitable contribution of the LCs. Since it is clear that this conclusion would be reached if X had actually received the appropriate LCs from the central bank and had then physically transferred them to Z, the fact that the procedure was condensed by a transfer of the LCs directly from the central bank to Z should not change that result. As in Situations 1 and 2, we believe that the correct analysis in Situation 3 is to treat X as redeeming the Obligation for LCs.

To allow a loss to X from a taxable sale is especially justifiable in Situation 3 since, in charitable contribution situations similar to this, the sequence of events is normally respected for tax purposes. Thus, if a donor gives appreciated property to a charitable organization under circumstances where it is clear that the charitable organization will sell the property (and indeed may direct the donor's broker to sell it

on the charity's behalf), it is well recognized that so long as the donor has not obligated the charitable donee to sell the property, the donor will be treated as having contributed the property and will not be taxable on the gain when the charity sells it. This is true even though the donor would be taxable on the gain if the sequence were reversed and the property were sold first, followed immediately by a gift of the proceeds.[9] Conversely, where there is an existing obligation of the charity to dispose of the property, it is appropriate to treat the donor as having sold the property and donated the proceeds. For these reasons, in Rev. Rul. 87-124, Situation 3, the Service properly treated the transaction as though the LCs, not the Obligation, had been donated to Z by X.

We note in passing that treating X as having disposed of the Obligation to the central bank leaves open the same possibility as in Situations 1 and 2 of bifurcating the transactions so that X is treating as receiving and contributing to Z some of the LCs (an amount equal to the value of the Obligation at free market exchange rates for the LCs) while the central bank also makes a further contribution of its own in exchange for Z accepting the targeted use of all the LCs.

B. Availability of the Deduction. Under Section 170(c)(2)(A), a charitable contribution is allowed only on a

[9] Cf. S.C. Johnson & Son. Inc. v. Commissioner, 63 T.C. 778 (1978), and Rev. Rul. 60-370, 1960-2 C.B. 203.

gift to an organization "created or organized in the United States . . . A gift to a foreign organization is not deductible.[10]

Rev. Rul. 63-252, 1963-2 C.B. 101, and Rev. Rul. 66-79, 1966-1 C.B. 48, set forth the standards that are to be used in determining whether a gift to a domestic charity is deductible where the donated funds are to be used in a foreign country.[11] Rev. Rul. 63-252 provides that if a U.S. organization accepts contributions that are earmarked for the unrestricted use of a foreign charity, the contribution will not be deductible because the foreign organization is the actual recipient of the contribution, i.e., the domestic charity is viewed merely as a conduit. Both Rev. Rul. 63-252 and Rev.

Rul. 66-79 establish an important exception to this rule, however, by holding that the gift will be treated as made to a U.S. organization so as to be deductible if the U.S. charitable organization (1) exercises discretion in reviewing and approving the uses or projects to which contributions will be devoted, and (2) requires a periodic accounting by the foreign

---

[10] Under Section 170(c)(2), the contribution by a corporation to a trust, chest, fund or foundation (as opposed to a contribution to another corporation) is deductible only if the gift is to be used within the United States or any of its possessions. A corporate contribution to a corporate charity created or organized in the United States can be deductible even though the gift is to be used outside the United States.

[11] Rev. Rul. 87-124 specifically refers to these two rulings.

recipient of such funds to demonstrate that the contributions are used for approved purposes.

According to Rev. Rul. 66-79, the question is whether the U.S. organization "has full control of the donated funds and discretion as to their use, so as to insure that they will be used to carry out its functions and purposes." This conclusion is amplified in Rev. Rul. 75-65, 1975-1 C.B. 79, which permitted a deduction for contributions to a U.S. conservation organization for use in foreign countries where the U.S. entity "maintained control and responsibility over the use of any funds granted a foreign organization by first making a field investigation of the purpose to which the funds will be put, by then entering into a written agreement with the recipient organization, and lastly by making continuous field investigations to see that the money is expended in accordance with the agreement." See also Brinley v. Commissioner, 782 F.2d 1326, 1335 (5th Cir. 1986).[12]

[12] The Steuerle letter cites these three rulings and states, citing the Brinley case, that there is "also authority indicating that, in some circumstances, it may be possible for funds to be credited to the account of a foreign charity if use of funds in that amount is limited to a specific charitable purpose and the U.S. charity had exercised discretion in selecting that charitable purpose." We question that conclusion. Brinley involved a gift of money to an individual to be used to pay his expenses at a church missionary training camp, and the court determined that since the reimbursed expenses were incurred in connection with the charitable activities of the church, the contributions should be treated for tax purposes as having been made to the church. We do not believe that the same result would or should be reached in the case of a contribution to a non-qualified charitable organization for use by that organization merely because a qualified charitable organization selects the purpose for which the donated funds are to be expended.

We therefore believe that Rev. Rul. 87-124 is correct in concluding that X is entitled to a charitable contribution deduction equal to the fair market value of the appropriate LCs (either 900 LCs valued with the restriction on use or LCs on an unrestricted basis equal to the fair market value of the Obligation, but in either case the difference between $100 and the loss X recognizes on the exchange of the Obligation).

Collateral Issues

There are two important collateral issues to developing country debt-equity swaps that Rev. Rul. 87-124 does not address. While they are beyond the scope of this report, we believe that it would be very beneficial for the Service to provide additional guidance on them.

One is the further tax consequences in each situation at the level of FX or Z. Depending upon the approach taken, FX or Z will have a corresponding tax basis for U.S. tax purposes equal to $100 reduced for whatever taxable loss is allowed to X (or to X and Y in the aggregate in Situation 1). Assuming that the 900 LCs ultimately will be expended and produce the same benefit to

FX or Z as would an equal amount of LCs purchased on the "free market," a reconciliation of the extra value realized will have to be addressed. The consequences would appear to depend upon how the situations are characterized. Moreover, the assessment may also depend upon the relevant functional currency of FX.

For example, if FX were treated as receiving a subsidy from the foreign government, the usual rules of Section 362(c) presumably would apply, with FX either having a zero basis in the subsidy LCs or a reduced basis in some of its property, depending upon whether the LCs are treated as functional currency of FX so as to be "money" to FX. A subsidy to Z from the foreign government presumably would be treated as a contribution. If, alternatively, FX or Z is treated as receiving the Obligation with a carryover basis, the conversion by it to the LCs presumably would result in a recognized gain or loss to the extent relevant, again with potential valuation issues depending upon what is the relevant functional currency. If, in the further alternative, FX or Z were treated as receiving all the LCs from X or Z, and the LCs received were not its functional currency, expenditure of the LCs presumably would lead to a sale of property by FX or Z producing a recognized gain or loss; if the LCs were received by FX as its functional currency, the consequences may be less clear and possibly involve only a potential shareholder gain to X or Y on a later liquidation or distribution from FX.

The second issue relates to how the "free market" exchange rate is to be determined to the extent it is relevant. Generally speaking, it would be the rate at which the currency is traded on the New York or other financial markets.[13] Cooper v. Commissioner, 15 T.C. 757 (1950). It should be noted, however, that although the reference in Rev. Rul. 87-124 probably is to that rate, some courts have used the "black market rate" to determine currency related gains and losses. Cinelli v. Commissioner, 502 F.2d 695 (6th Cir. 1974); Ternovsky v. Commissioner, 66 T.C. 695 (1976).[14] Moreover, at least one court has taken a different approach from that in Rev. Rul. 87-124 and has adopted a conversion rate for blocked foreign currency obligations measured on the basis of the respective price indices in the United States and the foreign country with respect to commodities that could be readily purchased in the foreign country during the taxable year. Eder v. Commissioner, 138 F.2d 27 (2nd Cir. 1943).

---

[13] The free market rate rather than the official rate clearly is the appropriate rate to use. See Rev. Rul. 84-1,43, 1984-2 C.B. 127.

[14] The black market rate sometimes is referred to as the “uncontrolled free” or “unofficial free” rate. Durovic v. Commissioner, 65 T.C. 480, 488 (1975).