Internal Revenue Service

Number: **200627006**
Release Date: 7/7/2006
Index Number: 171.07-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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, ID No.
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Refer Reply To:
CC:FIP:B02
PLR-140562-05
Date:
March 14, 2006

LEGEND

Taxpayer =

Bond A =
Bond B =
Bond C =
Bond D =

City =

Dear :

This is in response to your request for rulings dated July 8, 2005, and subsequent correspondence. You have requested advice on how to account for Bonds A through D.

FACTS

Taxpayer's investment portfolio includes tax-exempt callable Bonds A through D, each of which was issued by City with original issue discount (OID) and provides for qualified stated interest (QSI) as defined in section 1.1273-1(c) of the Income Tax Regulations. Taxpayer acquired each Bond subsequent to its original issuance for a cash purchase price in excess of the sum of all amounts payable on the Bond after the acquisition date (other than payments of QSI).

APPLICABLE LAW & ANALYSIS

Section 171 of the Internal Revenue Code sets forth special rules that must be followed by a holder of a tax-exempt obligation to account for bond premium.

Section 1.171-1(c) provides that a holder acquires a bond at a premium if the holder's basis[1] in the bond immediately after its acquisition by the holder exceeds the sum of all amounts payable on the bond after the acquisition (other than payments of QSI).

Section 171 and the regulations thereunder set forth special rules that must be followed by a holder of a tax-exempt obligation to account for bond premium. See sections 1.171-1(c), 1.171-2(a)(4)(ii), 1.171-2(c) ex. 4.

Section 1272(a)(1) provides that a holder of a debt instrument generally must include in gross income the sum of the daily portions of OID for each day during the taxable year the holder held the debt instrument. Section 1272(a)(2) excludes tax-exempt obligations from the purview of section 1272. Section 1272(c)(1) excludes debt instruments purchased at a premium.

Section 1288(a)(2) generally provides that OID on any tax-exempt obligation shall be treated as accruing, for purposes of determining the adjusted basis of the holder, in the manner provided by section 1272(a) including the rules of section 1272(a)(7).

ANALYSIS & CONCLUSIONS

Taxpayer acquired each Bond for an amount greater than the sum of all amounts payable on the Bond after the Bond's acquisition date (other than payments of QSI) and Taxpayer's basis in each Bond under section 1012 was equal to this amount. As a result, Taxpayer acquired each Bond at a premium for purposes of section 171 and the regulations thereunder. See section 1.171-1(d); see also section 1.1272-2(b)(2).

Under section 1.171-1(c)(1), Taxpayer must amortize the premium on each Bond. Section 1.171-2 provides rules for amortizing the premium. In general, the premium is amortized on a constant yield basis and the amortizable premium for an accrual period offsets the QSI allocable to the accrual period.[2] Under section 1.1016-5(b)(3), for each year a Bond is held by Taxpayer, Taxpayer must reduce his basis in the Bond by the amount of the Bond's excess premium that is amortized in that year on the Bond. See section 1.171-2(c) Example 4 for an example of how to amortize bond premium on a tax-exempt bond. Because the Bonds were acquired by Taxpayer at a premium, the

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[1] In general, the basis of property is the cost thereof. Section 1012. The cost is the amount paid for the property in cash or other property. Section 1.1012-1.

[2] A bond subject to call provisions is subject to the rules in 171(b) for callable bonds. For example, bond premium on a callable bond is determined and amortized by reference to an earlier call date only if the use of the call date (rather than the bond's stated maturity date) would result in a slower recovery of premium. See 171(b)(1)(B)(ii).

OID on the Bonds is not includible in Taxpayer's gross income. Moreover, Taxpayer's basis in each Bond is not adjusted pursuant to section 1288.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

William E. Coppersmith
William E. Coppersmith
Branch Chief, Branch 2
Office of the Associate Chief Counsel
(Financial Institutions & Products)