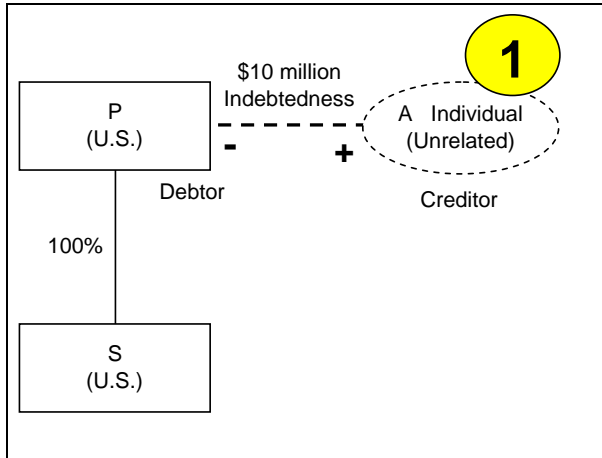


**Revenue Ruling 2004-79,
Situation 1**

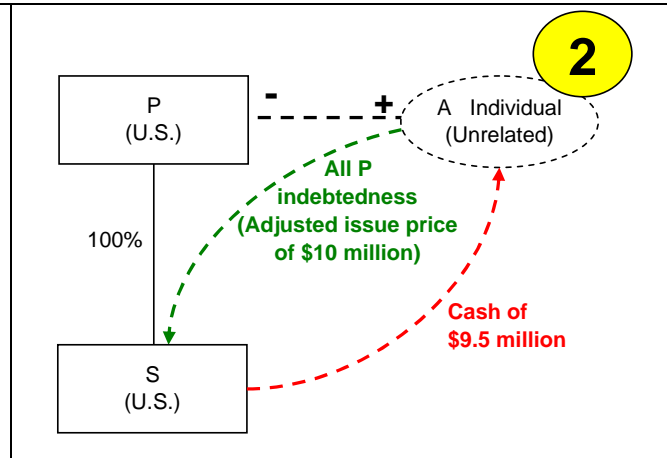
**Subsidiary Purchase of
Parent Debt**

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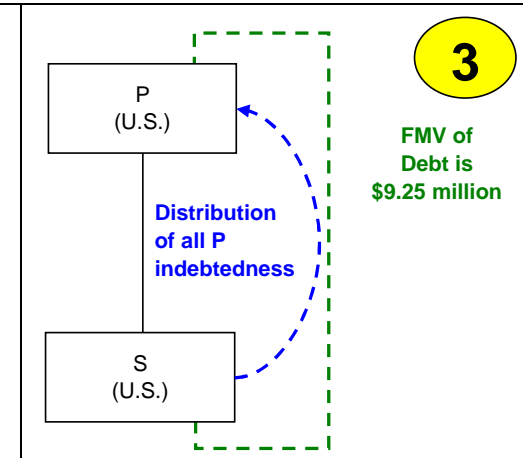
Initial Structure (Jan. 1, Year 1)



Subsidiary Purchase of Debt (Jan. 1, Year 2)



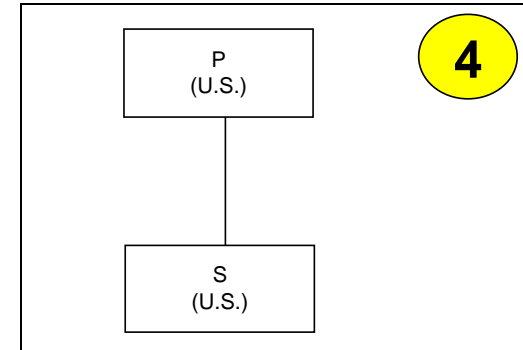
Distribution (Jan. 1, Year 3)



P and S have a relationship specified in section 267(b)(3). Therefore, under section 108(e)(4), S's purchase of the P indebtedness is treated as P's acquisition of that indebtedness. Because S purchased the P indebtedness for an amount less than its adjusted issue price ("AIP"), P is treated as realizing income from the discharge of indebtedness. P indebtedness is treated as new indebtedness issued by P to S on the acquisition date. The new indebtedness is deemed issued with an issue price equal to S's adjusted basis in the indebtedness, \$9,500,000. The \$500,000 excess of the stated redemption price at maturity of the indebtedness (\$10,000,000) over its deemed issue price (\$9,500,000) is OID. In Year 2, P deducts from gross income and S includes in gross income OID of \$147,868. Accordingly, as of January 1 of Year 3, the AIP of the new indebtedness and S's adjusted basis in the indebtedness is \$9,647,868.

S's distribution of the P indebtedness to P is a distribution of property described in section 301. Under section 301(b), the amount of such distribution is the fair market value of the property distributed, \$9,250,000. Under section 301(c), because as of the end of Year 3 S has earnings and profits in excess of that amount, the distribution in its entirety is treated as a dividend to P. Additionally, because the distribution of the P indebtedness to P extinguishes the indebtedness, P is treated as having repurchased its indebtedness for an amount equal to the fair market value of the indebtedness, \$9,250,000. Accordingly, P realizes income from the discharge of indebtedness in an amount equal to \$397,868, the excess of the adjusted issue price of the P indebtedness (\$9,647,868) over the amount of the distribution (\$9,250,000). Under section 311(a), S does not recognize the loss inherent in the P indebtedness on the distribution of the P indebtedness. As a result of the distribution, pursuant to section 312(a), S's earnings and profits are reduced by its adjusted basis in the P indebtedness distributed, \$9,647,868.

Ending Point



AIP at time of purchase	\$10,000,000
Purchase Price	\$9,500,000
COD income	\$500,000
AIP at time of distribution	\$9,647,868
FMV at time of distribution	\$9,250,000
COD income	\$397,868