Revenue Ruling 90-79

Non-Deductible Personal Currency Loss on Foreign Mortgage

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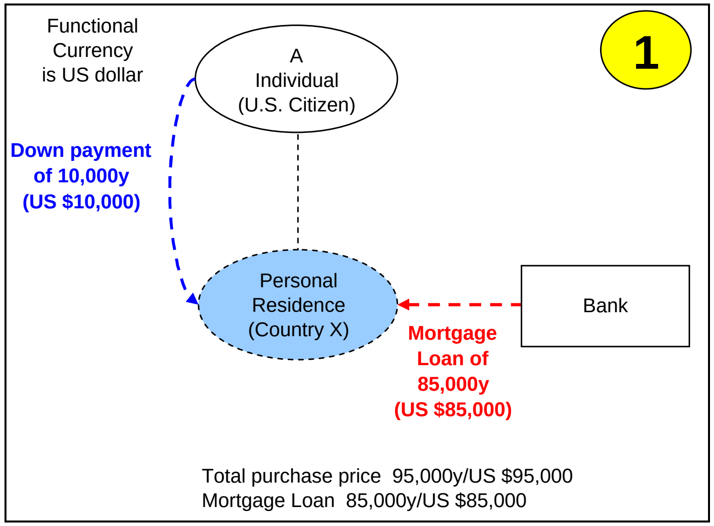
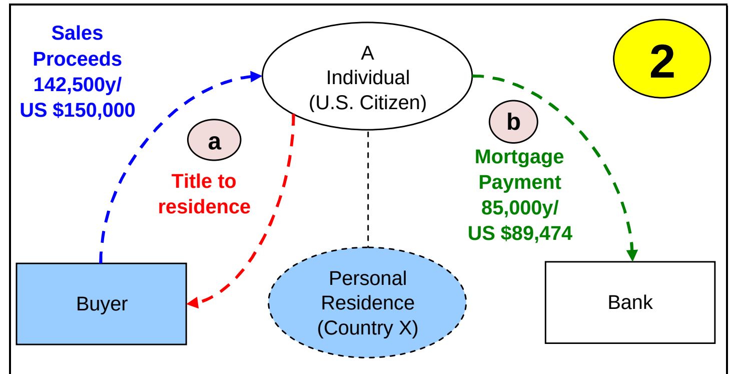
In 1986 A, an individual U.S. citizen, purchased property in country X that A used exclusively as a personal residence. The purchase price was 95,000y. A financed the purchase with a loan of 85,000y when $1 equaled 1y, and 10,000y cash payment. In 1989 A sold the personal residence for 142,500y, and used 85,000y of the sale proceeds to repay the outstanding principal balance of the mortgage. At the time of the sale and repayment, $1 equaled .95y. A's basis in the personal residence is $95,000 (95,000y at $1 equals 1y). The amount realized upon the sale of the residence is $150,000 (142,500y at $1 equals .95y); therefore, A realizes a gain of $55,000 ($150,000 - $95,000).

Purchase of Foreign Residence (1986)



Sale of Residence (1989)



	Local Currency	US$	Exchange Rate
Amount realized	142,500	150,000	$1 to .95y
Less Tax Basis	(95,000)	(95,000)	$1 to 1 y
Gain on Sale	47,500	55,000	Taxable Gain
Debt "Basis" in Mortgage	85,000	85,000	$1 to 1y
Less Mortgage repayment	(85,000)	(89,474)	$1 to .95y
Gain (Loss) on repayment	0	(4,474)	Non-deductible personal loss

A's functional currency under section 985(b)(1) is the U.S. dollar. The y is a nonfunctional currency with respect to A. None of the expenses incurred by A in connection with the purchase, financing, or sale of the personal residence were deductible under section 162 or section 212(1) or (2).

Section 985(a) generally provides that all income tax determinations shall be made in a taxpayer's functional currency. An individual may have a qualified business unit (QBU) that has a non-dollar functional currency. See Reg. 1.989(a)-1(b). However, an activity that does not generate expenses that are deductible under either section 162 or section 212(1) or (2) does not qualify as a QBU. See Reg. 1.989(a)-1(c). Therefore, A must make all income tax determinations with respect to the purchase, financing, and sale of the personal residence in U.S. dollars.

Section 988 provides rules for the treatment of "section 988 transactions", including becoming an obligor under a mortgage. Section 988(c)(1)(B)(i). However, under section 988(e), the rules of section 988 apply to a transaction entered into by an individual only to the extent expenses allocable to the transaction meets the requirements of section 162 or section 212(1) or (2). Because there are no expenses properly allocable to the mortgage that meet the requirements of either section 162 or section 212(1) or (2), the rules of section 988 do not apply to A's becoming an obligor under the mortgage. Therefore, the law predating section 988 governs. Under the law predating section 988, the borrowing and repayment of the mortgage loan is a separate transaction from the purchase and sale of the personal residence. The repayment of the mortgage by A constitutes a closed, and therefore, taxable transaction. Since the y increased in value against the dollar between the time A's liability was fixed (at the time of the borrowing) and the time A repaid the loan, the amount of dollars required to retire the debt exceeded the dollar value of the amount originally borrowed. Therefore, A realized a loss on the loan repayment. The amount of the loss is $4,474. (The dollar value of 85,000y borrowed: $85,000, less the dollar value of 85,000y used to repay the loan: $89,474). Section 165(a) provides generally that a deduction shall be allowed for losses sustained during a taxable year and not compensated for by insurance or otherwise. Section 165(c) limits the loss deduction for individuals to losses incurred in a trade or business, losses incurred in any transaction entered into for profit, and casualty losses. Thus, an individual is not allowed to deduct all realized losses. A's loss was not incurred in an activity or as the result of an event described in section 165(c). Therefore A may not deduct the $4,474 realized loss.