

ERNST & ERNST

1000 CONNECTICUT AVENUE, N.W.

WASHINGTON, D. C. 20036

December 19, 1975

Mr. Charles M. Walker
Assistant Secretary (Tax Policy)
Department of the Treasury
Washington, D. C. 20225

Dear Mr. Walker:

The Municipal Assistance Corporation for the City of New York (MAC) has made an offer to the holders of certain short-term notes of the City of New York to exchange their short-term notes for long-term MAC bonds. One of the factors bank holders of the short-term notes will have to weigh in determining whether to make the exchange is the tax aspects of the transaction. Therefore, it is respectfully recommended that the Treasury Department consider publication of a release at the earliest possible time setting forth the tax consequences with respect to the exchanging noteholders.

It is further recommended that the following tax results obtain upon the exchange by a banking institution of the short-term New York City notes for the long-term MAC bonds:

1. An exchanging noteholder will have ordinary gain or loss on the exchange under §582(c) of the Internal Revenue Code, measured by the difference between the fair market value of a MAC bond on the date of exchange and the adjusted basis of the short-term New York City note. Presumably, the fair market value at the date of exchange would be determined by reference to the initial offering price at which a substantial portion of the MAC bonds will be sold. (Cf. Regs. §1.1232-3 (b) (2) (i).)
2. The exchanging noteholders will have original issue discount equal to the difference between the fair market value of an exchanged note (which is presumably equal to the fair market value of a MAC bond) and the face amount of the MAC bond. Such original issue discount will be treated as tax-exempt interest which will be amortized over the life of the bond. In the event the bondholder disposes of the bond before maturity, the portion of original issue discount to be treated as tax-exempt interest would be that amount which

On 2/5/76
PAM and I met
with Rosen to
discuss these
issues. We agreed
that if a private
ruling were
submitted
on the issue
we would
attempt to
get the
response

We thought it
would be useful to
get a private
ruling submitted
so that the facts
could be built
set forth

RSK

I said that
you to a
would like

Benno, Hoover
Bad Debt

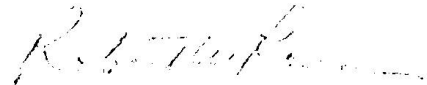
Two benefits
1) ord. deduct
in exchange for
tax exempt int
2) may deduct
ord

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bears the same ratio to the total original issue discount as the number of days the bonds are held bears to the total number of days from the issue date to the maturity date.
(See Rev. Rul. 73-112, 1973-1 CB 47.)

We would be glad to offer any assistance to your office in connection with our recommendations.

Very truly yours,



Robert M. Rosen
Partner

RMR:lp

1. In light of 582(c) does §1232 apply at all? §1232(a) - are they corp. int. assets in their hands?
2. Are either the bonds rec. or traded securities given up or an established market?
3. Is the trade off result ordinary loss for tax exempt income?
4. What is the §585 issue?