

This reasoning is equally applicable to the question of the source of original issue discount income and, it is submitted, requires that the source of such income, like interest, be determined by the status of the payer.

2. *Earned original issue discount upon State and local obligations constitutes tax-free interest*

Section 103(a) of the Code exempts "interest" on state and local obligations from income tax. Where a state or municipality issues its bonds at a discount, the question arises whether a taxpayer who has purchased the bonds may treat as exempt under section 103(a) that portion of his gain upon sale or redemption of the bond as is attributable to the period he held it.

The Service has long answered this question affirmatively. G.C.M. 10452, XI-1 C.B. 18; I.T. 2629, XI-1 C.B. 20; G.C.M. 21890, 1940-1 C.B. 85; Rev. Rul. 60-210, 1960-1 C.B. 38. As stated in Rev. Rul. 60-210, the ruling position of the Service has been that:

"* * * discount at which bonds and similar obligations were *issued* constitutes compensation (where noninterest-bearing), or additional compensation (where interest-bearing), which the obligor had contracted to pay for the use of the money loaned and, hence, was equivalent to interest for Federal income tax purposes. * * *" 1960-1 C.B. at page 39, emphasis in the original.

The approach of the Service, exemplified in the quoted passage from Rev. Rul. 60-210, coincides with the rationale of the *Midland-Ross* and *Dixon* decisions. As suggested under the preceding heading, the same considerations apply with equal force in determining the source of original issue discount income.

3. *Where a corporation sells its bonds it may amortize original issue discount and deduct the amount amortized over the life of the bonds in the same manner as annual interest*

Section 1.61-12(c) (3) of the Income Tax Regulations provides, in pertinent part, that:

"If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. * * *"

This Regulation is another example of the general rule that original issue discount is to be treated as interest for income tax purposes. As explained by the Supreme Court in a case allowing deduction of amortization of bond discount and of related commissions incurred in marketing the bonds:

"Both commissions and discount, as the Government concedes, are factors in arriving at the actual amount of interest paid for the use of capital procured by a bond issue. The difference between the capital realized by the issue and par value, which is to be paid at maturity, must be added to the aggregate coupon payments in order to arrive at the total interest paid. * * *" *Helvering v. Union Pacific Railroad Company*, 293 U.S. 282, 286 (1934).

4. *Original issue discount income is treated as interest for personal holding company purposes*

Under Section 543(a) (1) of the Code, "personal holding company income" includes "interest". As noted earlier in this memorandum, the Regulations under Section 543 provide that: