(a) Comments Due Date

The FAA must receive comments on this airworthiness directive (AD) by September 28, 2026.

(b) Affected ADs

None.

(c) Applicability

This AD applies to all Airbus Helicopters Model H160–B Helicopters, certificated in any category, that were delivered before October 21, 2025.

(d) Subject

Joint Aircraft System Component (JASC) 2550, Cargo compartments.

(e) Unsafe Condition

This AD was prompted by a determination that a gap without fire-resistant sealant (sealant) may be present in the cargo bay near the fuel segregation box. The FAA is issuing this AD to detect and correct missing sealant. The unsafe condition, if not addressed, could jeopardize the fire-resistant characteristic of the cargo compartment, which could result in reduced control of the helicopter in case of fire.

(f) Compliance

Comply with this AD within the compliance times specified, unless already done.

(g) Required Actions

Except as specified in paragraphs (h) and (i) of this AD: Comply with all required actions and compliance times specified in, and in accordance with, European Union Aviation Safety Agency AD 2025–0279, dated December 10, 2025 (EASA AD 2025–0279).

(h) Exceptions to EASA AD 2025–0279

(1) Where EASA AD 2025–0279 refers to its effective date, this AD requires using the effective date of this AD.

(2) Where EASA AD 2025–0279 requires compliance in terms of flight hours, this AD requires using hours time-in-service.

(3) This AD does not adopt the ''Remarks'' section of EASA AD 2025–0279.

(i) No Reporting Requirement

Although the material referenced in EASA AD 2025–0279 specifies to submit certain information to the manufacturer, this AD does not require that action.

(j) Alternative Methods of Compliance (AMOCs)

(1) The Manager, International Validation Branch, FAA, has the authority to approve AMOCs for this AD, if requested using the procedures found in 14 CFR 39.19. In accordance with 14 CFR 39.19, send your request to your principal inspector or local Flight Standards District Office, as appropriate. If sending information directly to the manager of the International Validation Branch, send it to the attention of the person identified in paragraph (k) of this AD and email to: *AMOC@faa.gov.*

(2) Before using any approved AMOC, notify your appropriate principal inspector, or lacking a principal inspector, the manager of the local flight standards district office/certificate holding district office.

(k) Additional Information

For more information about this AD, contact Waqar Shah, Aviation Safety Engineer, FAA, 1600 Stewart Avenue, Suite 410, Westbury, NY 11590; phone: (316) 946–4120; email: *waqar.h.shah@faa.gov*.

(l) Material Incorporated by Reference

(1) The Director of the Federal Register approved the incorporation by reference of the material listed in this paragraph under 5 U.S.C. 552(a) and 1 CFR part 51.

(2) You must use this material as applicable to do the actions required by this AD, unless the AD specifies otherwise.

(i) European Union Aviation Safety Agency (EASA) AD 2025–0279, dated December 10, 2025.

(ii) [Reserved]

(3) For EASA material identified in this AD, contact EASA, Konrad-Adenauer-Ufer 3, 50668 Cologne, Germany; phone: +49 221 8999 000; email: *ADs@easa.europa.eu;* website: *easa.europa.eu*. You may find the EASA material on the EASA website at *ad.easa.europa.eu.*

(4) You may view this material at the FAA, Airworthiness Products Section, Operational Safety Branch, 10101 Hillwood Parkway, Fort Worth, TX 76177. For information on the availability of this material at the FAA, call (817) 222–5110.

(5) You may view this material at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, visit *www.archives.gov/federal-register/cfr/ibr-locations* or email *fr.inspection@nara.gov.*

Issued on August 6, 2026.

Steven W. Thompson,

Acting Deputy Director, Compliance & Airworthiness Division, Aircraft Certification Service.

[FR Doc. 2026–16640 Filed 8–13–26; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–103844–26]

RIN 1545–BS16

Foreign Currency Gain or Loss of Controlled Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations providing rules relating to the determination and recognition of foreign currency gain or loss with respect to qualified business units (''QBUs'') of controlled foreign corporations (''CFCs''). The proposed regulations provide an election under which a CFC generally would not be required to compute or recognize foreign currency gain or loss upon a remittance from a QBU, except in connection with certain inbound nonrecognition transactions.

DATES: Written or electronic comments and requests for a public hearing must be received by November 12, 2026.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG–103844–26) by following the online instructions for submitting comments. Requests for a public hearing must be submitted as prescribed in the ''Comments and Requests for a Public Hearing'' section. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments submitted to the IRS's public docket. Send paper submissions to: CC:PA:01:PR (REG–103844–26), Room 5503, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Mark Terrell at (202) 317–6938; concerning submissions of comments or requests for a public hearing, the Publications and Regulations Section at (202) 317–6901 (not toll-free numbers) or by email at *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Authority

This document contains proposed additions and amendments to 26 CFR part 1 (Income Tax Regulations) addressing the application of section 987 of the Internal Revenue Code (''Code'') and related provisions (the ''proposed regulations''). The additions and amendments are issued under sections 987 and 989, pursuant to the express delegations of authority provided under those sections. The express delegations relied upon are referenced in the Background section of this preamble. The proposed regulations are also issued under the express delegation of authority under section 7805(a).

Background

I. Overview

Section 987 applies to any taxpayer that has a qualified business unit (''QBU'') with a functional currency other than the dollar. Section 987(1) and (2) provide rules for determining and translating taxable income or loss (''section 987 taxable income or loss'') with respect to a QBU that is subject to section 987 (''section 987 QBU''). In addition, section 987(3) requires proper adjustments (as prescribed by the Secretary) for transfers of property between QBUs of the taxpayer having different functional currencies (including transfers of property between a controlled foreign corporation (''CFC'') and its QBUs). Under section 987(3), a taxpayer that owns a QBU generally must recognize foreign currency gain or loss (''section 987 gain or loss'') upon a remittance from the QBU.

Sections 987 and 989 provide several explicit grants of regulatory authority. Section 987(3) directs the Secretary to prescribe proper adjustments for transfers of property between QBUs of the taxpayer having different functional currencies. Section 989(c) directs the Secretary to ''prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subpart.'' [1]

On December 11, 2024, the Treasury Department and the IRS published Treasury Decision 10016, which contained final regulations under sections 861, 985, 987 through 989, and 1502 (the ''2024 final regulations''), in the **Federal Register** (89 FR 100138). Concurrently with the publication of the 2024 final regulations, the Treasury Department and the IRS published a notice of proposed rulemaking (REG–117213–24) under section 987, which addressed the treatment of frequently recurring disregarded transactions (the ''2024 proposed regulations''), in the **Federal Register** (89 FR 99782).

On February 25, 2026, the Treasury Department and the IRS issued Notice 2026–17, 2026–12 IRB 698, which announced that proposed regulations would be issued under section 987 for the purpose of simplifying the operation of the 2024 final regulations, reducing compliance burdens, and refining the scope of certain rules under section 987 to limit their effect on ordinary course transactions.

II. Application of Section 987 to Controlled Foreign Corporations

A. 2024 Final Regulations

The 2024 final regulations provide that section 987(3) and the related regulations apply to CFCs in which at least one United States shareholder (''U.S. shareholder''), within the meaning of section 951(b), directly or indirectly owns stock, within the meaning of section 958(a). *See* § 1.987–1(b)(1).

B. 2024 Proposed Regulations

The preamble to the 2024 proposed regulations requested comments as to whether the final regulations should be modified to provide that section 987(3) does not apply to CFCs. The preamble explained that, when a United States person (''U.S. person'') owns a section 987 QBU, foreign currency gain or loss must be recognized under section 987(3) in order to accurately measure the U.S. person's accession to wealth in U.S. dollars. By contrast, alternative rules may be appropriate in the case of a section 987 QBU owned by a CFC, because a CFC is permitted to compute its income in a functional currency other than the dollar. *See* section 985(b).

In the preamble to the 2024 proposed regulations, however, the Treasury Department and the IRS also expressed concern that, if section 987(3) were not applied to a section 987 QBU owned by a CFC, the CFC's basis in assets distributed from the section 987 QBU could be increased or reduced due to exchange rate fluctuations. This is because, in the absence of special rules requiring the CFC to track basis in the section 987 QBU's assets using historic exchange rates, the CFC's basis in assets distributed by the section 987 QBU would be translated at the spot rate on the date of the distribution. If the U.S. shareholders of the CFC were then to ultimately sell their CFC stock in a taxable transaction, the gain or loss recognized on the sale generally would reflect any economic foreign currency gain or loss attributable to the distributed assets. However, in the case of an inbound liquidation or reorganization, asset basis attributable to appreciation in the value of the section 987 QBU's functional currency could be imported into the United States without a corresponding income inclusion. As a result, economic foreign currency gain with respect to the assets distributed by the section 987 QBU would permanently escape U.S. taxation.

C. Comments Received in Response to the 2024 Proposed Regulations

The Treasury Department and the IRS received several comments in response to the 2024 proposed regulations. Two of the commenters requested that CFCs be excluded completely from the application of section 987(3). The commenters noted that section 987(3) provides the Secretary with discretion to determine the nature of the proper adjustments required to account for foreign currency gain or loss with respect to a QBU. The commenters asserted that, if section 987(3) did not apply to CFCs, foreign currency gain or loss with respect to a section 987 QBU of a CFC typically would be accounted for under other provisions of the Code (for example, under section 301(c)(3)). Therefore, according to the commenters, it would not be necessary for a CFC to separately recognize section 987 gain or loss.

D. Notice 2026–17

Notice 2026–17 announced that the Treasury Department and the IRS intend to issue forthcoming proposed regulations that would provide an election under which CFCs generally would not compute or recognize section 987 gain or loss with respect to their section 987 QBUs. The Notice described the rules and procedures for making the election (including consistency requirements) that would apply under the proposed regulations. The Notice explained that, under the rules of the proposed regulations, unrecognized section 987 gain or loss of a CFC arising before the election was made would be amortized over a period of 120 months, consistent with the elective rules for amortizing pretransition gain or loss under the 2024 final regulations. *See* § 1.987–10(e)(5)(ii). The Notice further explained that the proposed regulations would require taxpayers to account for foreign currency gain (but not loss) in the case of an inbound liquidation or reorganization described in § 1.367(b)–3(a) of a CFC that is subject to the election.

Although Notice 2026–17 summarized the rules that would be provided in the proposed regulations relating to the CFC election and its consequences, the Notice did not describe these rules in detail. In addition, the Notice did not permit taxpayers to rely on the rules relating to the CFC election.

Notice 2026–17 also announced that the proposed regulations would (i) permit taxpayers to determine section 987 taxable income or loss and section 987 gain or loss using an equity and basis pool method that is substantially similar to the method provided in regulations proposed in 1991; (ii) narrow the scope of the loss suspension rules; (iii) simplify the loss-to-the-extent-of-gain rule under which suspended section 987 loss is recognized; (iv) modify the definition of a successor for purposes of the deferral rules; and (v) expand the definition of a section 987 hedging transaction. The Notice described rules expected to be included in the proposed regulations regarding these issues and provided that

[1] The reference to ''this subpart'' refers to subpart J of part III of subchapter N of chapter 1 of the Code, which includes section 987.

taxpayers are permitted to rely on these rules. Proposed regulations addressing these provisions of Notice 2026–17 will be included in a future notice of proposed rulemaking.

E. Comments Received in Response to Notice 2026–17

The Treasury Department and the IRS received a number of comments in response to Notice 2026–17. The commenters generally requested that guidance relating to the CFC election be issued as quickly as possible, so that taxpayers have sufficient time to make the election for the 2025 taxable year. Several of the recommendations made by the commenters are addressed in the Explanation of Provisions section of this preamble. The Treasury Department and the IRS are continuing to evaluate the remaining comments and will address these comments in future guidance.

III. Election To Amortize Pretransition Gain or Loss

The 2024 final regulations provide transition rules for the determination and recognition of section 987 gain or loss that arose before the 2024 final regulations became applicable (''pretransition gain or loss''). *See* § 1.987–10. In particular, under § 1.987–10(e)(5)(ii)(A), taxpayers can elect to recognize pretransition gain or loss ratably over the transition period (the ''amortization election''). Under the 2024 final regulations, the transition period is a period of ten taxable years beginning with the first taxable year in which the section 987 regulations apply. Therefore, a taxpayer that makes the amortization election recognizes one tenth of its pretransition gain or loss in each year of the transition period, including short taxable years.

In Notice 2025–72, 2025–51 IRB 840, the Treasury Department and the IRS announced that proposed regulations would modify the effect of the amortization election for short taxable years by providing that pretransition gain or loss is recognized ratably over a period of 120 months. Thus, for example, in a one-month short taxable year, the owner would recognize 1/120th (rather than one tenth) of its pretransition gain or loss.

Explanation of Provisions

I. CFC Exemption Election

A. Overview

Consistent with Notice 2026–17, the proposed regulations would permit taxpayers to make an election (''CFC exemption election'') that would limit the application of section 987(3) and the related regulations with respect to CFCs. Proposed § 1.987–15. In a taxable year to which the election applies, a CFC generally would not compute or recognize section 987 gain or loss, except in connection with certain inbound nonrecognition transactions. Proposed § 1.987–15(b). However, the rules of section 987(1) and (2) would continue to apply, for example, for purposes of computing the taxable income and earnings and profits of the CFC.

The CFC exemption election is intended to reduce the compliance and administrative burdens of applying section 987(3) with respect to section 987 QBUs owned by CFCs. Additional flexibility is warranted in this context because, under section 985, many CFCs have a functional currency other than the U.S. dollar; thus, a CFC's income is not necessarily measured by its accession to wealth in U.S. dollar terms. Moreover, if a CFC does not recognize section 987 gain or loss with respect to a section 987 QBU, the economic currency gain or loss with respect to the section 987 QBU generally should be taken into account by the CFC's U.S. shareholders under other provisions of the Code (for example, in the case of a taxable sale of the CFC stock, under section 1001), such that the U.S. shareholders would, over time, recognize the correct amount of total income with respect to the CFC.

Section 987(3) provides broad authority to prescribe proper adjustments for transfers of property between QBUs of the taxpayer having different functional currencies. Section 989(c) also provides broad authority to ''prescribe such regulations as may be necessary or appropriate to carry out the purposes'' of subpart J. The Treasury Department and the IRS are of the view that this authority allows for special elective rules to be prescribed with respect to CFCs that are different from the rules applicable to U.S. persons.

The proposed regulations would provide that, for taxable years in which the CFC exemption election is in effect, a CFC generally would not compute or recognize section 987 gain or loss. However, as explained in parts I.E and I.G of this Explanation of Provisions, a CFC would continue to compute and recognize section 987 gain or loss that arises in taxable years for which the CFC exemption election is not in effect, and a CFC would be required to recognize section 987 gain in connection with certain inbound transactions when a CFC exemption election is in effect.

B. Rules for Making and Revoking the Election

1. In General

A CFC exemption election would be a section 987 election within the meaning of § 1.987–1(g) and, therefore, would be subject to the general rules for making and revoking elections under § 1.987–1(g). In general, the election would be made by filing an election statement before the start of the taxable year. Proposed § 1.987–1(g)(3)(ii)(D)(*3*). However, as described in part I.B.2 of this Explanation of Provisions, the proposed regulations would provide special rules for taxable years beginning after December 31, 2024, and ending on or before December 31, 2027. The CFC exemption election could not be revoked without the consent of the Commissioner. *See* § 1.987–1(g)(3)(ii)(A).

2. Taxable Years Beginning After December 31, 2024, and Ending on or Before December 31, 2027

Notice 2026–17 stated that the CFC exemption election would generally be made on an original, timely filed return (including extensions). Commenters noted that many calendar year taxpayers will already have finished preparing their original tax returns for the 2025 taxable year by the time the proposed regulations are issued. The commenters asserted that it may be difficult for these taxpayers to make the computations needed to account for the CFC exemption election on their timely filed original tax returns for the 2025 taxable year. Two commenters recommended that, for taxable years beginning in 2025, taxpayers should be permitted to make the CFC exemption election on an amended return filed before a specified date (either the original tax return due date, with extensions, for the 2026 taxable year, or when final regulations are published).

The Treasury Department and the IRS agree that additional flexibility is appropriate in making the CFC exemption election for the 2025 taxable year. In addition, the Treasury Department and the IRS acknowledge that transition issues may also arise for the 2026 and 2027 taxable years. Accordingly, the proposed regulations provide special election timing rules for taxable years beginning after December 31, 2024, and ending on or before December 31, 2027.

In general, for taxable years beginning after December 31, 2024, and ending on or before December 31, 2026, the authorized person (within the meaning of § 1.987–1(g)(1)) would make the CFC exemption election by attaching an election statement to its original, timely filed (including extensions) return. Proposed § 1.987–1(g)(3)(ii)(D)(*1*). Alternatively, for taxable years beginning in 2025, taxpayers would be permitted to make the CFC exemption election on an amended return filed by October 15, 2027. *Id.*

For taxable years ending in 2027, the authorized person would make the CFC exemption election by filing the election statement on or before October 15, 2027. Proposed § 1.987–1(g)(3)(ii)(D)(*2*). Thus, until October 15, 2027, a calendar year taxpayer would be permitted to make the election for the 2025, 2026, or 2027 taxable years.

This timetable is intended to provide sufficient time for taxpayers to determine whether to make the CFC exemption election after the issuance of final regulations providing for the election, while ensuring that the deadline for any of these three taxable years does not fall earlier than the deadline for a preceding taxable year. The general rule contained in proposed § 1.987–1(g)(3)(ii)(D)(*3*) would apply for taxable years ending after December 31, 2027. Thus, a calendar year taxpayer would be required to make a CFC exemption election for the 2028 taxable year on or before December 31, 2027.

3. Taxable Year for Which the CFC Exemption Election First Becomes Relevant

As an alternative to the rules described in parts I.B.1 and I.B.2 of this Explanation of Provisions, for the taxable year in which the CFC exemption election first becomes relevant, the authorized person could also make a CFC exemption election by attaching an election statement to its original, timely filed (including extensions) return. Proposed § 1.987–1(g)(3)(ii)(D)(*4*). This rule would provide additional time to make the election if the CFC exemption election first becomes relevant for a taxable year ending after December 31, 2026.

For this purpose, the CFC exemption election first becomes relevant in the first taxable year beginning after December 31, 2024, in which the authorized person's section 987 electing group includes a CFC that is the owner of a section 987 QBU. Thus, for example, the alternative rule in proposed § 1.987–1(g)(3)(ii)(D)(*4*) could apply to a taxable year beginning after December 31, 2024, in which a domestic corporation acquired all the stock of a CFC that owned a section 987 QBU, but only if the domestic corporation did not own a majority of the stock of any other CFC that owned a section 987 QBU in any previous taxable year beginning after December 31, 2024.

C. Consistency Requirements

1. In General

Under § 1.987–1(g)(2)(ii), section 987 elections must be made consistently for all members of a section 987 electing group, including all CFCs in which a majority of the stock, by vote or value, is owned (within the meaning of section 958(a)) by the same U.S. shareholder. When a CFC joins a section 987 electing group, it is deemed to make or revoke any section 987 election as necessary to be consistent with the other group members.

The proposed regulations would provide additional consistency requirements to ensure that this election is made on a uniform basis for all CFCs that are commonly controlled by affiliated U.S. shareholders. Under proposed § 1.987–15(c)(2)(i), all domestic corporations that are affiliated (within the meaning of § 1.904(i)–1(b)) would be required to make consistent CFC exemption elections with respect to their majority-owned CFCs. This rule would require consistent CFC exemption elections between certain related but non-consolidated domestic corporations. For example, proposed § 1.987–15(c)(2)(i) would require consistency between separate consolidated groups that are commonly owned by a foreign parent corporation, and between domestic corporations that would be members of the same consolidated group but for the interposition of a partnership. In addition, under proposed § 1.987–15(c)(2)(ii), a U.S. person would be treated as owning CFC stock that it holds indirectly through a domestic partnership (by treating a domestic partnership in the same manner as a foreign partnership in applying section 958(a)).

The proposed regulations also would provide anti-avoidance rules to prevent taxpayers from entering into related-party transactions designed to avoid the consistency requirements or trigger a deemed revocation of a CFC exemption election. Proposed § 1.987–15(c)(3).

2. Acquisitions

A commenter requested additional guidance regarding the application of the consistency rules when a CFC that is not subject to a CFC exemption election (or its U.S. shareholder) is acquired by an unrelated party that has made a CFC exemption election (or vice versa). The commenter noted that, when an acquirer with minimal section 987 exposure acquires a CFC that owns a substantial number of section 987 QBUs, it may not be appropriate for the acquirer's elections to remain in effect. The commenter suggested that guidance be provided either solely with respect to the CFC exemption election or with respect to section 987 elections more generally.

The Treasury Department and the IRS are continuing to study the appropriate application of the consistency rules in § 1.987–1(g) and proposed § 1.987–15(c) to cases in which a CFC (or another domestic or foreign entity) is acquired by an unrelated party. The Treasury Department and the IRS request comments on this issue in general, including whether special rules should be provided for cases in which an acquired CFC's taxable year does not end at the time of the acquisition and to coordinate the consistency rules with the statutory changes (including the modifications to the pro rata share rules) in Public Law 119–21, 139 Stat. 72 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA), and the related regulations.

D. Effect of the CFC Exemption Election

1. In General

If a CFC is subject to a CFC exemption election (an ''exempt CFC''), the rules of the section 987 regulations relating to the determination and recognition of section 987 gain or loss (for example, §§ 1.987–4 through 1.987–6 and 1.987–11 through 1.987–14) generally would not apply to the exempt CFC. Proposed § 1.987–15(b)(2). However, other parts of the section 987 regulations (for example, § 1.987–3, which relates to the determination of section 987 taxable income or loss) would continue to apply to the exempt CFC. Thus, for example, a taxpayer could make an election to use a spot rate convention under § 1.987–1(c)(1)(ii) or a section 988 mark-to-market election under § 1.987–3(b)(4)(ii) with respect to an exempt CFC.

The applicable rules of the section 987 regulations would be applied by deeming a current rate election to be in effect with respect to each exempt CFC, so that exempt CFCs would not be required to track historic exchange rates. Proposed § 1.987–15(b)(3)(i). As a result, the amount of a section 987 QBU's taxable income or loss would be translated into the owner's functional currency at the yearly average exchange rate, and transfers between a section 987 QBU and its owner would be translated at the spot rate applicable on the date of the transfer.

2. Partnerships Owned by CFCs

a. Rules of the 2024 Final Regulations Relating to Partnerships

The 2024 final regulations do not provide detailed rules concerning the determination of section 987 taxable income or loss and section 987 gain or loss in the case of a partnership. Thus, taxpayers must apply sections 987 and 989(a) with respect to partnerships using a reasonable method consistent with the statute, and this method must be applied consistently from year to year. *See* § 1.987–7(b).

For example, assume a CFC with the U.S. dollar as its functional currency owns an interest in a foreign partnership that would be viewed as using the euro as its functional currency if the partnership were treated as a QBU under section 989(a), and the partnership owns an eligible QBU that uses the Swiss franc as its functional currency. The CFC could apply section 987 using an aggregate approach, under which the CFC is treated as the indirect owner of its proportionate interest in the eligible QBU. Alternatively, under an entity approach, the partnership itself could be treated as a section 987 QBU of the CFC, and the eligible QBU could be treated as a section 987 QBU of the partnership.

b. Rules of the Proposed Regulations Relating to Partnerships Owned by CFCs

The proposed regulations would provide rules relating to the effect of a CFC exemption election when an exempt CFC is a partner in a partnership. These rules generally are intended to provide parity between the treatment of a section 987 QBU that is directly owned by an exempt CFC and the treatment of a section 987 QBU that is owned by (or through) a partnership whose partners are exempt CFCs.

Under proposed § 1.987–7(b)(2), an exempt CFC generally would not compute or recognize section 987 gain or loss with respect to an ''exempt partnership QBU,'' which would be defined to include (i) a partnership that is treated as a section 987 QBU of an exempt CFC or (ii) a section 987 QBU that is indirectly owned by an exempt CFC through a partnership. Proposed § 1.987–7(b)(2)(iii). However, an exempt CFC would be required to continue to apply the rules of sections 987(1) and (2) and 989(a) with respect to its exempt partnership QBUs in a reasonable manner using a method that is applied consistently from year to year. Proposed § 1.987–7(b)(2).

Similarly, if a partnership is treated as the owner of a section 987 QBU, and at least 80 percent of the capital or profits interests in the partnership are owned by exempt CFCs that are members of the same controlled group (an ''exempt partnership''), the section 987 QBU would be an exempt partnership QBU, and the exempt partnership generally would not compute or recognize section 987 gain or loss with respect to the exempt partnership QBU. Proposed § 1.987–7(b)(2)(iii) and (iv). However, the exempt partnership would be required to continue to apply the rules of sections 987(1) and (2) and 989(a) in a reasonable manner using a method that is applied consistently from year to year. Proposed § 1.987–7(b)(2). Thus, an exempt partnership generally would be treated in the same manner as an exempt CFC for purposes of section 987. For this purpose, an exempt CFC would be treated as owning a partnership interest that it holds indirectly through one or more other partnerships. Proposed § 1.987–7(b)(2)(ii).

If a partnership meets the definition of an exempt partnership in the taxable year in which a CFC exemption election is made, the rules of proposed § 1.987–15 would apply to the exempt partnership beginning in that taxable year. If a partnership becomes an exempt partnership in a later taxable year (for example, because an exempt CFC acquires an interest in the partnership), the rules of proposed § 1.987–15 would be applied to the exempt partnership by treating the CFC exemption election as having been made for that taxable year. Proposed § 1.987–15(g)(3)(iii). Similarly, in a taxable year in which a partnership ceases to be treated as an exempt partnership (for example, because an exempt CFC disposes of its partnership interest), the rules of proposed § 1.987–15 would be applied to the partnership by treating the CFC exemption election as having been revoked for that taxable year. Proposed § 1.987–15(g)(3)(iv).

E. Pre-Election Section 987 Gain or Loss

1. Requirement To Compute and Amortize Pre-Election Section 987 Gain or Loss

a. Comments Received in Response to Notice 2026–17

Notice 2026–17 explained that, beginning in the first taxable year in which a CFC exemption election is made, unrecognized section 987 gain or loss that arose in previous taxable years (''pre-election section 987 gain or loss'') would be amortized over a period of 120 months. The Treasury Department and the IRS received several comments recommending that taxpayers be permitted to elect whether or not to compute and recognize pre-election section 987 gain or loss. The commenters posited that, if the CFC exemption election is intended to prevent the application of section 987(3) with respect to exempt CFCs, then exempt CFCs should not be required to account for section 987 gain or loss that arose before the CFC exemption election was made. Further, the comments asserted that the computation of pre-election section 987 gain or loss would be burdensome for taxpayers.

b. Proposed Rules Requiring Computation and Amortization of Pre-Election Section 987 Gain or Loss

In general, the proposed regulations would require taxpayers to compute and amortize pre-election section 987 gain or loss, and they would not permit taxpayers to elect out of this requirement.[2] See parts I.E.3 and I.E.4 of this Explanation of Provisions for a detailed description of the proposed rules for computing and amortizing pre-election section 987 gain or loss.

Contrary to the commenters' suggestion, the CFC exemption election is intended to narrow, rather than wholly prevent, the application of section 987(3) to exempt CFCs. Thus, the proposed regulations would leave in place the default rule of § 1.987–1(b)(1), which provides that section 987(3) applies to CFCs. However, pursuant to the authority to prescribe proper adjustments under section 987(3), the proposed regulations would provide an election that would limit the circumstances in which an exempt CFC would recognize section 987 gain or loss. An exempt CFC generally would not be required to recognize section 987 gain or loss in taxable years for which the election applies, but it would be required to amortize pre-election section 987 gain or loss, and it may also be required to recognize section 987 gain in the case of an inbound reorganization or liquidation.

The Treasury Department and the IRS are concerned that the election requested by the commenters would allow taxpayers to eliminate previously computed amounts of section 987 gain or loss in a manner similar to the elective ''fresh start'' transition method that was provided in earlier proposed regulations under section 987 (the ''2006 proposed regulations'') that were published in the **Federal Register** in 2006 (71 FR 52876, September 7, 2006). In response to the 2006 proposed

[2] As explained in part I.E.1.c of this Explanation of Provisions, the proposed regulations would provide special rules to relieve the compliance burden of computing pre-election section 987 gain or loss with respect to smaller QBUs of exempt CFCs.

regulations, a commenter asserted that this election was overly favorable to taxpayers and would have one-sided effects that would be detrimental to the fisc. Consistent with this comment, the 2024 final regulations require taxpayers to account for pretransition gain or loss under § 1.987–10 and do not permit use of the fresh start transition method on an elective basis. For similar reasons, the Treasury Department and the IRS are of the view that the election requested by the commenters would expose the government to whipsaw. Taxpayers with substantial pre-election section 987 gain could choose to eliminate the gain, while taxpayers with substantial pre-election section 987 loss could amortize the loss over 120 months.

Accordingly, proposed § 1.987–15(e) generally would require taxpayers that make a CFC exemption election to compute pre-election section 987 gain or loss and amortize this gain or loss over a ten-year period. This rule would ensure that section 987 gain or loss arising before the taxable year of the CFC exemption election is properly taken into account.

c. Exception for QBUs With Assets of Less Than $50 Million

Although proposed § 1.987–15(e) generally would require taxpayers to compute and recognize pre-election section 987 gain or loss, the Treasury Department and the IRS acknowledge that, depending on the size of a QBU, the burden of this computation may outweigh its rationale. Therefore, the proposed regulations would provide an exception to the general rule of proposed § 1.987–15(e) for QBUs that hold assets of less than $50 million.

Under proposed § 1.987–15(e)(2)(iii), an exempt CFC would be deemed to have zero pre-election section 987 gain or loss with respect to a QBU that has average assets of less than $50 million for the three-year period preceding the first taxable year for which the election is made. *See* proposed § 1.987–15(e)(2)(iii)(B)(*1*). The three-year averaging requirement is intended to prevent inappropriate shifting of assets between QBUs. All QBUs of an exempt CFC or exempt partnership with the same country of residence (as defined in section 988(a)(3)(B)) would be aggregated for purposes of the $50 million threshold. Proposed § 1.987–15(e)(2)(iii)(B)(*3*).

For this purpose, the amount of a QBU's assets for each of the three years preceding the first taxable year for which the CFC exemption election is made would be equal to the amount of total assets reflected on the QBU's U.S. GAAP balance sheet on the last day of the relevant taxable year (which is reported annually on Form 8858, Schedule F). Proposed § 1.987–15(e)(2)(iii)(B)(*2*). Unlike the items attributable to an eligible QBU under § 1.987–2(b)(1), these amounts are not adjusted to conform to Federal income tax principles. Based on available data, the Treasury Department and the IRS anticipate that this exception would substantially reduce the overall compliance burden of computing pre-election section 987 gain or loss.

2. Coordination With the Transition Rules of § 1.987–10

The rules for computing and recognizing pre-election section 987 gain or loss under proposed § 1.987–15(e) generally would not apply if the CFC exemption election is made for the taxable year beginning on the transition date described in § 1.987–10(c)(1) (that is, the first day of the first taxable year to which the 2024 final regulations apply). In this case, because unrecognized section 987 gain or loss arising before the transition date is already accounted for under the transition rules of § 1.987–10, taxpayers would not be required to separately account for pre-election section 987 gain or loss under proposed § 1.987–15(e). However, because the transition rules of § 1.987–10 do not apply to partnerships, an exempt CFC or exempt partnership would compute pre-election section 987 gain or loss under proposed § 1.987–15(e) with respect to an exempt partnership QBU even when the CFC exemption election is made in the taxable year beginning on the transition date. Proposed § 1.987–15(g)(1)(i).

In general, a CFC exemption election would not affect the application of the transition rules in § 1.987–10. Thus, in the taxable year beginning on the transition date, an exempt CFC would apply § 1.987–10 to determine pretransition gain or loss with respect to its section 987 QBUs. Additionally, the rules cross-referenced in § 1.987–10 (for example, the rules of § 1.987–4 that are cross-referenced in § 1.987–10(e)(3)(iii)) would apply for purposes of the transition rules. However, if the CFC exemption election is made for the taxable year beginning on the transition date, an exempt CFC would be deemed to have no pretransition gain or loss with respect to a QBU that does not meet the $50 million asset threshold under proposed § 1.987–15(e)(2)(iii). Proposed § 1.987–15(d)(2).

A taxpayer that makes a CFC exemption election for the taxable year beginning on the transition date would be deemed to also make the amortization election under § 1.987–10(e)(5)(ii) with respect to its exempt CFCs. Proposed § 1.987–15(d)(1)(i). Because an exempt CFC does not recognize section 987 gain or loss under § 1.987–5 at the time of a remittance, this deemed election is needed to provide a mechanism for recognizing an exempt CFC's pretransition gain or loss. A taxpayer that is deemed to make the amortization election by reason of a CFC exemption election would not be required to make the amortization election with respect to QBU owners that are not exempt CFCs. Proposed § 1.987–15(d)(1)(ii).

3. Computation of Pre-Election Section 987 Gain or Loss if the CFC Exemption Election Is Made After the Taxable Year Beginning on the Transition Date

a. In General

If a CFC exemption election is made for a taxable year beginning after the transition date, an exempt CFC (or an exempt partnership) generally would be required to compute pre-election section 987 gain or loss with respect to its section 987 QBUs, successor deferral QBUs, and successor suspended loss QBUs as of the last day of the preceding taxable year. Proposed § 1.987–15(e)(2). An exempt CFC's pre-election section 987 gain or loss with respect to a QBU would be equal to the sum of the CFC's net unrecognized section 987 gain or loss, outstanding deferred section 987 gain or loss, and cumulative suspended section 987 loss with respect to the QBU on the last day of the preceding taxable year, reduced by amounts recognized in the preceding taxable year. *Id.*

b. Interaction With the Annual Recognition Election

Commenters requested clarification concerning the interaction of an annual recognition election with a CFC exemption election. Under proposed § 1.987–15(e)(2), any section 987 gain or loss recognized before the first taxable year in which the CFC exemption election applies would not be taken into account in computing pre-election section 987 gain or loss. Therefore, if a CFC is subject to an annual recognition election before the CFC exemption election is made, and the CFC does not have any outstanding deferred section 987 gain or loss or cumulative suspended section 987 loss, the CFC's pre-election section 987 gain or loss would be zero (because the CFC's net unrecognized section 987 gain or loss would have been recognized in prior taxable years as a result of the annual recognition election).

4. Recognition of Pre-Election Section 987 Gain or Loss

An exempt CFC would recognize pre-election section 987 gain or loss ratably over a period of 120 months beginning with the first day of the first taxable year in which the election applies. Proposed § 1.987–15(e)(3)(i). In general, the source and character of pre-election section 987 gain or loss would be determined by applying the rules of § 1.987–6 in the last taxable year before the CFC exemption election takes effect. Proposed § 1.987–6(b)(1)(v). However, deferred section 987 gain or loss and suspended section 987 loss would retain the source and character determined in the taxable year of deferral or suspension, respectively. *See* § 1.987–6(b)(1)(ii) and (iii).

It is possible that a CFC would amortize both pre-election section 987 gain or loss (under § 1.987–15(e)(3)(i)) and pretransition gain or loss (under § 1.987–10(e)(5)(ii)) in certain years. This would be the case, for example, if a calendar year CFC with a transition date of January 1, 2025, made the election to amortize pretransition gain or loss under § 1.987–10(e)(5)(ii) but did not make the CFC exemption election for 2025, and then made the CFC exemption election for 2026. However, if the CFC described in the preceding sentence owned a QBU that held assets of less than $50 million (as determined under proposed § 1.987–15(e)(2)(iii)(B)), the exempt CFC would continue to amortize pretransition gain or loss under § 1.987–10(e)(5)(ii) in 2026 and subsequent years, but would not amortize pre-election section 987 gain or loss with respect to the QBU under proposed § 1.987–15(e)(2)(iii).

5. Conversion of Pre-Election Section 987 Gain or Loss Into Suspended Section 987 Loss

In two cases, pre-election section 987 loss would be converted into suspended section 987 loss. First, under proposed § 1.987–15(e)(3)(iv), if pre-election section 987 loss of an exempt CFC is attributable to a QBU that is owned by a different member of the exempt CFC's controlled group (for example, a successor deferral QBU), and the exempt CFC ceases to be related to the owner of the QBU due to a transfer of the exempt CFC's stock, the pre-election section 987 loss would become suspended section 987 loss. This rule is intended to prevent taxpayers from engaging in loss trafficking by selling an exempt CFC with a pre-election section 987 loss attribute to an unrelated person that does not also acquire ownership of the QBU to which the loss is attributable. When this rule applies, the CFC would recognize the suspended section 987 loss only to the extent of section 987 gain recognized in a taxable year in which it is no longer subject to the CFC exemption election.

Second, under proposed § 1.987–15(f)(2)(ii), pre-election section 987 loss would be suspended if the CFC exemption election is revoked (or deemed to be revoked) during the first 60 months of the amortization period. This rule is intended to prevent taxpayers from making the CFC exemption election for a limited period of time in order to accelerate the recognition of section 987 loss.

6. Exempt Partnerships

An exempt partnership generally would be required to compute pre-election section 987 gain or loss in the same manner as an exempt CFC. Proposed § 1.987–15(g)(3)(i). However, the exempt partnership itself would not recognize the pre-election section 987 gain or loss. Instead, each partner in the exempt partnership would take into account its share of the pre-election section 987 gain or loss ratably over a period of 120 months. Proposed § 1.987–15(g)(3)(ii). This rule is designed to prevent pre-election section 987 gain or loss from being shifted to a new partner upon a sale or transfer of a partnership interest.

7. Partnership Basis Adjustments

Under the existing final regulations, when a partner recognizes section 987 gain or loss with respect to a partnership or an eligible QBU of a partnership, the partner's adjusted basis in the partnership must be adjusted under the principles of sections 704(d) and 705. *See* § 1.987–7(e). Therefore, partnership basis adjustments would be made for each taxable year in which an exempt CFC recognizes pre-election section 987 gain or loss with respect to an exempt partnership QBU (including a taxable year in which an exempt CFC recognizes pre-election section 987 gain or loss of an exempt partnership under proposed § 1.987–15(g)(3)(ii)(A)). The Treasury Department and the IRS request comments on this issue in general, including: whether it would be appropriate for an exempt CFC to instead adjust the basis of its partnership interest by the full amount of its pre-election section 987 gain or loss in the first taxable year in which the CFC exemption election applies; whether the recognition of pre-election section 987 gain or loss should be accelerated when an exempt CFC sells its partnership interest during the 120-month amortization period (including whether rules are needed to ensure that capital loss on the sale of a partnership interest is not converted into ordinary loss); and whether special rules should be provided for cases in which an exempt CFC transfers its partnership interest in a transaction described in section 351 or 721.

F. First Year for Which the Election Is Revoked

In the first year in which a CFC exemption election ceases to apply (for example, because the election is deemed to be revoked under the consistency rules in § 1.987–1(g)(2)), any section 987 QBU owned by the CFC would be deemed to be newly formed on the first day of the taxable year. Proposed § 1.987–15(f)(1). As a result, taxpayers would not be required to compute net unrecognized section 987 gain or loss under § 1.987–4 for previous taxable years in which the CFC exemption election was in effect.

G. Special Rules for Inbound Nonrecognition Transactions

1. Requirement To Account for Foreign Currency Gain

Notice 2026–17 explained that, under the rules to be provided in the proposed regulations, taxpayers would be required to account for foreign currency gain (but not loss) in the case of an inbound liquidation or reorganization of an exempt CFC. In response to the Notice, some commenters asserted that special rules for inbound transactions were not necessary and should not be included in the proposed regulations, or should be narrowly scoped to address transactions entered into with a principal purpose of abuse. Alternatively, the commenters suggested that symmetrical rules should be provided to account for foreign currency loss when the functional currency of a section 987 QBU depreciates in value. However, one commenter acknowledged that inbound transactions of exempt CFCs could present opportunities for importation of excess asset basis attributable to exchange rate fluctuations, which would implicate longstanding concerns of the Treasury Department and the IRS.

The Treasury Department and the IRS are of the view that rules are needed to prevent the importation of excess asset basis resulting from unrecognized foreign currency gains when the assets of an exempt CFC are acquired in an inbound reorganization or liquidation described in § 1.367(b)–3(a) (an ''inbound nonrecognition transaction''). In the absence of such rules, an exempt CFC would not currently recognize section 987 gain pursuant to the CFC exemption election, and could also permanently escape U.S. taxation with respect to economic foreign currency gain in the case of an inbound nonrecognition transaction. The related excess asset basis would be imported into the United States and could allow the domestic acquiring corporation to claim excessive deductions or losses in subsequent taxable years. *See* part II.B of the Background section.

Accordingly, under proposed § 1.987–16, when the assets of an exempt CFC (a ''transferor CFC'') are acquired in an inbound nonrecognition transaction, the transferor CFC would compute and recognize gain equal to the amount of its ''section 987 asset basis.'' Conceptually, section 987 asset basis is intended to reflect the amount by which the aggregate basis of the assets acquired in the inbound nonrecognition transaction has been increased due to appreciation in the value of a section 987 QBU's functional currency. This rule is consistent with one of the purposes of § 1.367(b)–3, which is to ensure that any asset basis repatriated in an inbound nonrecognition transaction either reflects earnings and profits that have already been subject to tax, or gives rise to an inclusion of income or recognition of gain at the time of the inbound nonrecognition transaction.

The Treasury Department and the IRS are of the view that an anti-abuse rule tied to a taxpayer's subjective intent would not sufficiently address concerns regarding the importation of excess asset basis. Because a CFC does not recognize section 987 gain on remittances from a section 987 QBU when a CFC exemption election is in effect, the CFC should recognize foreign currency gain when excess asset basis attributable to the section 987 QBU is imported into the United States, regardless of the taxpayer's reason for entering into the inbound nonrecognition transaction.

In addition, the proposed regulations do not provide rules under which a transferor CFC would recognize foreign currency loss in connection with an inbound nonrecognition transaction. The Treasury Department and the IRS are concerned that, if such rules were adopted, taxpayers could choose to enter into inbound nonrecognition transactions for the purpose of triggering substantial foreign currency losses. This approach is also consistent with the longstanding treatment under § 1.367(b)–3, which, upon an inbound nonrecognition transaction, requires an inclusion of income or recognition of gain and does not permit a deduction or recognition of loss. *See* §§ 1.367(b)–3(b)(3)(i) and (c)(2) and 1.367(b)–2(d)(1).

2. Computation of Section 987 Asset Basis

a. Comments Received in Response to Notice 2026–17

Notice 2026–17 identified two potential options for computing section 987 asset basis. Under the first option described in the Notice, section 987 asset basis would equal the transferor CFC's aggregate net unrecognized section 987 gain computed for a lookback period of ten taxable years preceding the inbound transaction, using the simplified method provided in § 1.987–10(e)(3). Under the second option, section 987 asset basis would be equal to the amount of the transferor CFC's excess asset basis computed under § 1.367(b)–3(g)(2)(i).

Two commenters recommended a modified version of the first option described in Notice 2026–17, under which the simplified method provided in § 1.987–10(e)(3) would be applied for only five years (rather than ten) unless taxpayers elected to utilize a ten-year lookback period. Another commenter asserted that the lookback period should not exceed ten years, but did not suggest a shorter period. Some commenters recommended that the simplified method provided in § 1.987–10(e)(3) should be applied using financial statement balance sheets. The commenters requested clarification as to whether adjustments would need to be made to the financial statement balance sheets for this purpose.

Other commenters suggested that section 987 asset basis be computed using a simplified version of the equity and basis pool method described in Notice 2026–17. One commenter requested that taxpayers be provided the option to compute section 987 asset basis by applying the rules of § 1.987–4(d) in their entirety to all taxable years preceding the inbound nonrecognition transaction.

Some commenters criticized the second option described in Notice 2026–17 (which looks to excess asset basis computed under § 1.367(b)–3(g)(2)(i)) because it does not isolate excess asset basis attributable to foreign currency gain with respect to a section 987 QBU. The commenters requested guidance as to how the foreign currency-related component of excess asset basis (''EAB'') could be identified for this purpose. Another commenter, however, asserted that the EAB method would be appropriate for taxpayers that are unable to use other methodologies due to data limitations.

Several commenters suggested that the cumulative translation adjustment (''CTA'') computed under GAAP could be used as a reasonable proxy for the amount of section 987 asset basis. The commenters requested guidance as to adjustments that would need to be made to the CTA amount for this purpose. One commenter recommended that taxpayers be permitted to use the CTA to compute section 987 asset basis only if the CTA methodology used for GAAP purposes is substantially similar to the computations required under section 987. However, the Treasury Department and the IRS also received feedback indicating that, as a result of remittances, disregarded transactions, and other factors, there can be significant book-to-tax differences between the CTA amount and section 987 gain or loss amounts, and it may not be feasible to provide administrable rules for making the necessary book-to-tax adjustments.

b. Proposed Rules for Computing Section 987 Asset Basis

The proposed regulations would provide rules for determining a transferor CFC's section 987 asset basis using administrable proxies based on information that is expected to be readily available at the time of the inbound nonrecognition transaction. These rules are intended to avoid the need for retroactive application of the rules of § 1.987–4 (for determining net unrecognized section 987 gain or loss) to prior taxable years based on historical information. The Treasury Department and the IRS are of the view that an approximation is appropriate in this context, given the limited circumstances under which the determination would be necessary (in light of the likely nonrecurring aspect of an inbound nonrecognition transaction) and the potential compliance and administrative burdens of requiring a precise calculation.

In particular, proposed § 1.987–16(c) would require the transferor CFC to determine its section 987 asset basis under one of two methodologies. The transferor CFC would establish its choice of methodology with respect to an inbound nonrecognition transaction by applying that methodology in computing the amount of section 987 asset basis (if any) to be recognized under proposed § 1.987–16(d)(1) with respect to the inbound nonrecognition transaction.

Under the first methodology (the ''lookback methodology''), section 987 asset basis would be equal to the aggregate net amount of unrecognized section 987 gain computed using the simplified method provided in § 1.987–10(e)(3) for taxable years ending within the 72-month period preceding the inbound nonrecognition transaction (excluding any taxable year predating the CFC exemption election). Proposed § 1.987–16(c)(2). This approach is expected to capture the appropriate amount of foreign currency gain for those taxable years with a reasonable degree of accuracy. In response to comments, the proposed regulations would provide for a lookback period of only 72 months (rather than ten years) in order to reduce the compliance burden of computing section 987 asset basis.

Under the second methodology, section 987 asset basis would be equal to the amount of EAB with respect to the transferor CFC determined under the rules of § 1.367(b)–3(g)(2)(i) (but without regard to the application of proposed § 1.987–16). Proposed § 1.987–16(c)(3). This approach relies on asset basis amounts determined at the time of the inbound nonrecognition transaction, rather than historical section 987 computations, and therefore may be simpler for taxpayers to apply in some cases. The other components of the EAB formula—earnings and profits and outside stock basis—are also expected to be available at the time of the inbound nonrecognition transaction. However, the Treasury Department and the IRS acknowledge that this approach can result in an imprecise amount of section 987 asset basis (for example, when the transferor CFC has excess asset basis for reasons unrelated to, or in addition to, exchange rate fluctuations).

The Treasury Department and the IRS are continuing to study whether, in addition to the two methodologies described in proposed § 1.987–16(c), other alternative methodologies recommended by commenters could be used to compute a transferor CFC's section 987 asset basis. Accordingly, the comments described in part I.G.2.a of this Explanation of Provisions may be addressed further in future guidance.

3. Gain Recognition

a. In General

Under proposed § 1.987–16(d)(1), a transferor CFC would recognize section 987 gain equal to the amount of its section 987 asset basis immediately before the inbound nonrecognition transaction. This rule aligns with the rules that apply when a CFC exemption election is not in effect. In particular, under § 1.987–8, all section 987 QBUs owned by a CFC are treated as terminated immediately before an inbound nonrecognition transaction, and any net unrecognized section 987 gain is recognized by the CFC at that time.

An example in the proposed regulations would confirm that section 987 gain recognized under proposed § 1.987–16(d)(1) is not gain recognized with respect to property distributed in a liquidation within the meaning of section 334(b)(1)(A) (or gain recognized on a transfer of property within the meaning of section 362(b)). *See* proposed § 1.987–16(f)(2)(iii). Under proposed § 1.987–16(d)(1), the section 987 gain would be recognized immediately before the inbound nonrecognition transaction, but not as part of the inbound nonrecognition transaction. Therefore, the domestic acquiring corporation's basis in the property received would not be affected by the recognition of section 987 gain under proposed § 1.987–16(d)(1).[3]

This result is appropriate because section 987 gain recognized under proposed § 1.987–16(d) is intended to reflect the amount by which a CFC's inside asset basis has previously been increased due to exchange rate fluctuations without gain recognition. If the domestic acquiring corporation's asset basis were increased under section 334(b)(1)(A) (or section 362(b)) due to the recognition of section 987 gain under proposed § 1.987–16(d), that would reintroduce the misalignment between asset basis and taxable income or gain that the rules of proposed § 1.987–16 are meant to address.

b. Source and Character

The source and character of section 987 gain recognized under § 1.987–16(d) would be determined under § 1.987–6 in the taxable year of recognition. Proposed § 1.987–6(b)(1)(vi). In general, source and character would be determined based on the relative tax book value of all of the transferor CFC's assets. Proposed § 1.987–16(d)(2)(ii). However, stock of a lower-tier subsidiary held by the transferor CFC would not be taken into account for this purpose, because this stock is not attributable to a section 987 QBU under § 1.987–2(b)(2)(i)(A).

c. Comments Received in Response to Notice 2026–17

In response to Notice 2026–17, the Treasury Department and the IRS received a number of comments regarding the manner in which section 987 asset basis should be taken into account. One commenter recommended that, immediately before the inbound nonrecognition transaction, the basis of the transferor CFC's assets should be reduced by the amount of its section 987 asset basis. Other commenters requested that taxpayers be permitted to elect between different methods for taking into account section 987 asset basis, including (i) gain recognition, (ii) adjustments to asset basis, and (iii) adjustments to the domestic acquiring corporation's net unrecognized section 987 gain or loss following the inbound nonrecognition transaction. The Treasury Department and the IRS are continuing to evaluate these comments. Accordingly, these comments may be addressed in future guidance.

4. De Minimis Rule

Under the proposed regulations, taxpayers would not be required to compute a transferor CFC's section 987 asset basis, or recognize an amount of section 987 gain equal to the section 987 asset basis, if the aggregate tax basis of the transferor CFC's assets is less than $25 million. Proposed § 1.987–16(e). This de minimis rule is intended to reduce the compliance and administrative burdens of applying § 1.987–16 when a CFC is unlikely to have a significant amount of section 987 asset basis. It is anticipated that the de minimis rule will relieve burdens on small businesses by eliminating the need for taxpayers to determine section 987 asset basis for a significant number of transactions.

In general, the $25 million de minimis threshold is applied with respect to all of a transferor CFC's assets, regardless of whether the assets are attributable to a section 987 QBU at the time of the inbound nonrecognition transaction. This rule is intended to ensure that any assets that may have been previously owned by a section 987 QBU are taken into account for purposes of the de minimis threshold, even if the assets were distributed to the transferor CFC (or the section 987 QBU terminated) before the inbound nonrecognition transaction.

Non-portfolio stock held by the transferor CFC generally would not be taken into account for purposes of the de minimis threshold, because this stock is not attributable to a section 987 QBU under § 1.987–2(b)(2)(i)(A). Proposed § 1.987–16(e)(2). Non-portfolio stock would, however, be taken into account to the extent that other assets of the transferor CFC had been exchanged for such stock (whether or not gain or loss was recognized on the exchange) during the 120-month period preceding the inbound nonrecognition transaction. Thus, for example, if a transferor CFC contributes a section 987 QBU to a lower-tier subsidiary in a section 351 transaction, the basis of the subsidiary

[3] The same principle would apply with respect to section 987 gain recognized when a section 987 QBU terminates under § 1.987–8.

stock received by the transferor CFC in exchange for the section 987 QBU would be taken into account under proposed § 1.987–16(e)(2).

The Treasury Department and the IRS received several comments relating to potential de minimis exceptions. One commenter suggested a de minimis rule tied to the amount of the CTA determined for GAAP purposes. Another commenter recommended that a de minimis exception should apply if the transferor CFC's inside asset basis does not exceed 10 percent of the aggregate gross basis of all of the domestic acquiring corporation's assets, or if the amount of section 987 asset basis is less than 10 percent of the transferor CFC's inside asset basis. The Treasury Department and the IRS are continuing to study these comments and will address them in future guidance.

5. Coordination With § 1.367(b)–3(g)

As described in part I.G.2.b of this Explanation of Provisions, the proposed regulations under § 1.987–16 would provide that excess asset basis has the meaning provided in § 1.367(b)–3(g)(2)(i) but is determined prior to the application of § 1.987–16(d). Proposed § 1.987–16(c)(3). To ensure that amounts that give rise to excess asset basis are not double counted (once in applying the proposed regulations under § 1.987–16(d) and again in applying § 1.367(b)–3(g)), § 1.367(b)–3(g)(2)(i) would be modified to provide that excess asset basis generally is determined after the application of § 1.987–16(d).

II. Amortization of Pretransition Gain or Loss in a Short Taxable Year

Consistent with Notice 2025–72, proposed § 1.987–10(e)(5)(ii)(A) would provide that an owner that is subject to an amortization election would recognize pretransition gain or loss ratably over a period of 120 months beginning with the first day of the first taxable year in which the section 987 regulations apply. This rule is intended to prevent distortions that could arise from the accelerated recognition of pretransition gain or loss in a short taxable year.

Applicability Dates

The proposed regulations generally are proposed to apply to taxable years ending on or after the date final regulations are filed with the **Federal Register** (the ''finalization date''). Proposed § 1.987–10(e)(5)(ii) (relating to the amortization election for pretransition gain or loss) is proposed to apply to taxable years beginning after December 31, 2024, and ending on or after November 25, 2025.

Except as provided in the following sentence, a taxpayer may rely on the proposed regulations for a taxable year beginning after December 31, 2024, and ending before the finalization date, provided that the taxpayer and all members of its consolidated group and section 987 electing group consistently follow the proposed regulations for the taxable year and all subsequent taxable years ending before the finalization date. A taxpayer may rely separately on proposed § 1.987–10(e)(5)(ii) for a taxable year beginning after December 31, 2024, and ending before the finalization date, provided that the taxpayer and all members of its consolidated group and section 987 electing group consistently follow proposed § 1.987–10(e)(5)(ii) for the taxable year and all subsequent taxable years ending before the finalization date.

Special Analyses

I. Regulatory Planning and Review—Economic Analysis

Executive Orders 12866 and 13563 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility. This rule is expected to be an Executive Order 14192 deregulatory action.

The proposed regulations have been designated by the Office of Management and Budget's (OMB's) Office of Information and Regulatory Affairs (OIRA) as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (MOA, July 4, 2025) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. OIRA has determined that the proposed rulemaking is a significant regulatory action and subject to review under section 3(f) of Executive Order 12866 and section 1(b) of the Memorandum of Agreement. Accordingly, the proposed regulations have been reviewed by OMB.

A. Background

Section 987 applies when a taxpayer owns a qualified business unit, or QBU, that has a functional currency different from the taxpayer's functional currency. In general, section 987(1) and (2) provide rules for determining and translating the QBU's taxable income or loss, while section 987(3) requires proper adjustments for transfers of property between QBUs with different functional currencies. In practical terms, section 987(3) generally requires the owner of a section 987 QBU to recognize foreign currency gain or loss when the QBU makes a remittance to its owner or is terminated.

The Treasury Department and the IRS have issued several sets of regulations and proposed regulations under section 987. In 1991, Treasury and the IRS issued proposed regulations that provided an earnings and capital method for determining section 987 gain or loss. Under that approach, taxpayers maintained an equity pool in the QBU's functional currency and a basis pool in the owner's functional currency; the equity pool generally represented the QBU's branch equity, and the basis pool generally represented the owner's basis in that branch equity. The pools were adjusted for the QBU's taxable income or loss and for contributions and remittances. During the years following the 1991 proposed regulations, many taxpayers became familiar with this framework.

In 2006, Treasury and the IRS issued new proposed regulations and withdrew the 1991 proposed regulations. The new proposed regulations were later finalized with modifications in 2016. Unlike the 1991 pool-based approach, the 2016 final regulations adopted a more detailed balance-sheet-based framework that required the recognition of currency gain or loss only on financial assets and liabilities, referred to as ''marked items,'' and not other assets and liabilities, referred to as ''historic items.'' In general, that framework required taxpayers to determine the items of income, gain, deduction, and loss attributable to a section 987 QBU in the QBU's functional currency and translate those items into the owner's functional currency, with the marked items referencing a spot exchange rate and the historic items referencing the historic exchange rate at which the item was acquired or incurred. The rules also required taxpayers to compute and maintain net unrecognized section 987 gain or loss with respect to each section 987 QBU, based on changes in the QBU's balance sheet, and to recognize a portion of that accumulated currency gain or loss when the QBU made a remittance to its owner. However, the applicability date of the 2016 final regulations was deferred several times, and taxpayers continued to face uncertainty about how to apply section 987 to their QBUs.

In December 2024, Treasury and the IRS finalized regulations under section 987 that retained the balance-sheet-based framework of the 2016 final regulations, with modifications intended to improve administrability, including an election (the current rate election) to recognize currency gain or loss with respect to all of a QBU's assets and liabilities, which eliminates the need to track historic exchange rates for historic items. The 2024 final regulations generally apply to taxable years beginning after December 31, 2024, and apply to CFCs that own section 987 QBUs. Under those rules, a CFC generally must determine section 987 taxable income or loss with respect to a section 987 QBU, compute net unrecognized section 987 gain or loss, and recognize section 987 gain or loss when the QBU makes a remittance or in connection with certain terminations. The 2024 final regulations also provide elections and related rules, including the current rate election, an annual recognition election, loss suspension rules, and transition rules for preexisting section 987 gain or loss.

At the same time, Treasury and the IRS issued 2024 proposed regulations addressing frequently recurring disregarded transactions between a section 987 QBU and its owner. Those proposed regulations also requested comments on the application of section 987 to partnerships and CFCs. In particular, Treasury and the IRS requested comments on whether section 987(3) and the related regulations should apply to CFCs, noting both the potential compliance burden of applying section 987(3) to section 987 QBUs of CFCs and the need to address concerns about excess asset basis in inbound transactions if section 987(3) were not applied to section 987 QBUs of CFCs.

In February 2026, Treasury and the IRS issued Notice 2026–17. The Notice announced forthcoming proposed regulations intended to simplify the operation of the 2024 final regulations, reduce compliance burdens, and limit the effect of certain section 987 rules on ordinary course transactions. In particular, the Notice described an election to use an equity and basis pool method for determining section 987 taxable income or loss and section 987 gain or loss, in lieu of certain balance-sheet-based computations under the 2024 final regulations. Under that method, taxpayers would generally maintain an equity pool in the section 987 QBU's functional currency and a basis pool in the owner's functional currency, with those pools adjusted for QBU income or loss and transfers between the QBU and its owner. In addition, the Notice announced that forthcoming proposed regulations would provide an election under which CFCs generally would not compute or recognize section 987 gain or loss under section 987(3), except in connection with certain inbound nonrecognition transactions.

The proposed regulations in this NPRM implement that CFC exemption election. Under the proposed regulations, taxpayers may elect to not apply section 987(3) and the related regulations generally to CFCs covered by the election (except to the extent provided in the proposed regulations). Section 987(1) and (2) would continue to apply, so CFCs would still determine and translate section 987 taxable income or loss as necessary for Federal income tax purposes. The proposed regulations also provide rules for making and revoking the election, consistency requirements for commonly controlled CFCs, treatment of pre-election section 987 gain or loss, and special rules for inbound nonrecognition transactions. The inbound nonrecognition transaction rules are intended to prevent exchange-rate-driven asset basis increases from being imported into the United States without appropriate recognition of section 987 gain. The other parts of Notice 2026–17 regarding the simplification of the 2024 final regulations will be addressed in other forthcoming proposed regulations.

B. Need for Proposed Regulations

Proposed regulations are needed to provide taxpayers with operative rules for making and applying the CFC exemption election, in order to reduce the compliance and administrative burdens of applying section 987(3) with respect to section 987 QBUs owned by CFCs. Notice 2026–17 announced that Treasury and the IRS intended to issue rules allowing CFCs generally not to compute or recognize section 987 gain or loss under section 987(3), except in connection with certain inbound nonrecognition transactions, but the Notice functioned as a preview of future guidance rather than a complete set of rules taxpayers could rely on to make the election.

Sections 987 and 989 provide regulatory authority for these rules. Section 987(3) directs the Secretary to prescribe the proper adjustments needed for transfers between QBUs with different functional currencies, and section 989(c) authorizes regulations necessary or appropriate to carry out the purposes of the foreign currency rules, including rules for related-party and QBU transactions.

Absent proposed regulations, taxpayers would not have the specific rules needed to implement the CFC exemption election on tax returns. Taxpayers need guidance on which CFCs are covered, who makes the election, when and how the election is made, whether the election must be applied consistently across commonly controlled CFCs, how pre-election section 987 gain or loss is treated, and what happens in inbound nonrecognition transactions or revocations of the election.

C. The Proposed Regulations

The proposed regulations provide an election, referred to as the CFC exemption election, under which an electing CFC generally would not compute or recognize section 987 gain or loss with respect to its section 987 QBUs, *i.e.,* branches or disregarded entities with functional currencies different from the CFC's functional currency. The election is intended to reduce the compliance and administrative burdens associated with applying the 2024 final regulations to CFCs that own section 987 QBUs.

The proposed regulations do not exempt CFCs from section 987 entirely. Section 987(1) and (2) would continue to apply for purposes of determining and translating section 987 taxable income or loss, including for purposes of computing taxable income and earnings and profits. Thus, the election is targeted at section 987(3) gain or loss recognition, rather than the broader rules for determining QBU income. For example, in taxable years in which the CFC exemption election is in effect, a CFC would continue to translate section 987 taxable income or loss under the applicable section 987 rules, generally using the yearly average exchange rate and by deeming a current rate election to be in effect. But if property is transferred from a section 987 QBU to the CFC owner in a transaction that would be treated as a remittance, the CFC generally would not compute or recognize section 987 gain or loss under section 987(3) as a result of that transfer.

The proposed regulations provide rules for making and revoking the CFC exemption election. In general, the election would be made by the authorized person for the relevant section 987 electing group. Special timing rules would apply for early years to allow taxpayers sufficient time to evaluate the election after issuance of the proposed and final regulations. The proposed regulations also provide that the election generally could not be revoked without the consent of the Commissioner. These rules are intended to make the election administrable and to reduce uncertainty for taxpayers preparing returns for the first years in which the 2024 final regulations apply.

The proposed regulations also include consistency requirements. The CFC exemption election generally must be made consistently for commonly controlled CFCs, including majority-owned CFCs of affiliated domestic corporations. The proposed regulations also include rules addressing CFC stock owned through domestic partnerships and an anti-avoidance rule for related-party transactions designed to avoid the consistency requirements or trigger an inappropriate deemed revocation. These rules are intended to prevent taxpayers from selectively applying the election to CFCs with expected section 987 gains while leaving other CFCs with expected section 987 losses outside the election.

The proposed regulations address section 987 gain or loss that arose before the CFC exemption election became effective. In general, an exempt CFC would compute its pre-election section 987 gain or loss and recognize that amount ratably over a 120-month period beginning with the first month of the taxable year for which the CFC exemption election is made. This rule preserves the tax consequences of section 987 gain or loss that accrued before the election by requiring both pre-election gain and pre-election loss to be taken into account over the same 120-month period. The proposed regulations would provide a mandatory asset basis test for certain smaller section 987 QBUs. Under this test, a QBU with assets of less than $50 million would not be required to compute or recognize pre-election unrecognized section 987 gain or loss in connection with the CFC exemption election. The $50 million threshold would be applied separately to each QBU (or to each group of same-country QBUs), based on the QBU's average assets for the three-year period preceding the first taxable year for which the election is made. This rule is intended to reduce transition-related compliance burdens for smaller QBUs for which the cost of computing pre-election section 987 pools may be relatively high compared to the potential tax amounts at issue.

The proposed regulations also provide rules for partnerships owned by exempt CFCs. If an exempt CFC owns a section 987 QBU through a partnership, or if a partnership is sufficiently owned by exempt CFCs, the proposed regulations generally would extend the CFC exemption election to the relevant QBU as if the QBU were owned directly by an exempt CFC. These rules are intended to provide similar treatment for section 987 QBUs owned directly by exempt CFCs and section 987 QBUs owned through partnerships by exempt CFCs, while continuing to require reasonable and consistent application of section 987(1), section 987(2), and section 989(a).

Finally, the proposed regulations include an important limitation on the election for certain inbound nonrecognition transactions. If an exempt CFC engages in an inbound liquidation or reorganization, the proposed regulations would require the CFC to recognize section 987 gain to the extent exchange-rate fluctuations have increased the basis of assets transferred to a domestic corporation in the transaction. This rule is intended to prevent unrecognized currency gain from increasing the basis of assets transferred to a domestic corporation without a corresponding income inclusion. For this purpose, the proposed regulations would provide two proxy methods for computing the amount of section 987 asset basis, giving taxpayers flexibility to use the method that is more administrable in their circumstances. The first method is based on net unrecognized section 987 gain over a specified historical period, and the second one is based on excess asset basis concepts under section 367(b). The proposed regulations would not provide a corresponding rule allowing an exempt CFC to recognize section 987 loss in an inbound transaction.[4] This limitation is intended to prevent taxpayers from using elective inbound transactions to selectively recognize losses, and is consistent with the longstanding treatment of inbound nonrecognition transactions under section 367(b), which does not permit the recognition of a deduction or loss. A de minimis rule would exclude certain smaller inbound transactions from the requirement to compute and recognize section 987 asset basis.

D. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the proposed regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations.

E. Economic Effects of the Proposed Regulations

1. Affected Taxpayers

The proposed regulations would affect U.S. taxpayers that own CFCs with section 987 QBUs. Based on 2023 filing-year data from the IRS Research, Applied Analytics, and Statistics Division, the Treasury Department and the IRS estimate that approximately 1,500 taxpayers would be affected by the proposed regulations. This estimate is based on the number of entities that own at least one CFC with a section 987 QBU.

The taxpayers most directly affected are multinational groups with CFCs that conduct foreign branch operations in currencies different from the functional currency of the CFC owner. These taxpayers may otherwise be required under the 2024 final regulations to compute and track section 987 gain or loss, remittances, transition amounts, and related attributes for their CFC-owned section 987 QBUs. Taxpayers that do not own CFCs with section 987 QBUs, or that do not make the CFC exemption election, generally would not be materially affected by the election rules.

2. Reduction in Compliance and Administrative Burden From the CFC Exemption Election

The principal economic effect of the proposed regulations is expected to be a reduction in recurring compliance and administrative burden for taxpayers that make the CFC exemption election. Under the baseline, CFCs generally must compute net unrecognized section 987 gain or loss and recognize section 987 gain or loss on remittances or certain terminations. These computations can require detailed information about section 987 QBU assets and liabilities, transfers between a QBU and its owner, exchange rates, remittances, suspended losses, deferred amounts, and transition items. By contrast, once the CFC exemption election applies, an electing CFC generally would not compute or recognize section 987 gain or loss under section 987(3) for ordinary CFC branch operations.

Public comments on prior section 987 regulations indicate that these computations can impose meaningful taxpayer-specific burdens. One commenter, a public company with approximately 10 to 15 QBUs using a functional currency different from their owner, stated that its historical section 987 monitoring and calculation burden had been approximately 20 hours or less per year, but that the 2016 section 987 regulations would require substantially

[4] This approach is consistent with the 2024 final regulations' treatment of suspended section 987 losses in inbound nonrecognition transactions, under which suspended losses generally are not imported into the United States and may be recognized only under the applicable loss-to-the-extent-of-gain rules.

more work.[5] The commenter estimated at least 80 hours merely to obtain a working knowledge of the rules, elections, and calculations, and at least 80 hours for a single QBU to transition to the Foreign Exchange Exposure Pool (FEEP) method in one example involving historic asset and exchange-rate tracking. The same commenter stated that annual calculations and disclosures would be needed for each QBU and would require weeks of work.

By allowing CFCs covered by the election generally not to compute or recognize section 987 gain or loss under section 987(3), the proposed regulations would reduce the need for ongoing section 987(3) computations for ordinary CFC branch operations. Taxpayers would still need to apply section 987(1) and (2) to determine and translate section 987 taxable income or loss, and certain computations would remain necessary for pre-election gain or loss and inbound nonrecognition transactions.[6] However, for electing taxpayers, the proposed regulations are expected to reduce recurring compliance costs and reduce the administrative burden on the IRS associated with reviewing routine CFC remittance computations.

The exact magnitude of these compliance cost savings is uncertain. Although the compliance burden reduction may encourage some taxpayers to make the CFC exemption election, it is possible not all eligible taxpayers will do so.[7] Further, available tax return data do not directly measure the number of hours taxpayers spend applying section 987(3) to each affected QBU, nor the exact cost associated with those hours worked. Treasury and the IRS therefore consider a range of estimates using three inputs: the number of affected section 987 QBUs, the hours saved per affected QBU, and the hourly labor cost of the tax professionals performing the work.

As noted above, it is estimated that approximately 1,500 entities own at least one CFC with a section 987 QBU. For a lower bound on the number of affected QBUs, it is assumed that two-thirds of the entities make the CFC exemption election, and that each entity owns only one CFC with one section 987 QBU, yielding 1,000 affected QBUs. However, many of these entities in fact own multiple CFCs with section 987 QBUs, and their compliance costs are therefore higher, as they must be incurred for each section 987 QBU. For an upper bound on the number of affected QBUs, it is assumed that all of the entities make the election, and that each owns three QBUs on average, yielding 4,500 affected QBUs.

For the number of hours saved per affected QBUs, Treasury and the IRS consider the compliance activities avoided and the public comment described above. These imply that the proposed regulations may reduce recurring compliance work by approximately 20–60 hours per affected QBU per year. The lower end reflects a conservative recurring burden estimate; the higher end reflects the greater complexity of applying the section 987 regulations to taxpayers with multiple currencies, multiple CFCs, frequent disregarded transactions, remittances, or more complex branch balance sheets. The hourly cost of this work is estimated using a monetization rate of $88.50 per hour, which IRS Research, Applied Analytics, and Statistics applies for certain information collection burdens specifically related to tax filing.

Using a central estimate of 4,500 affected QBUs, 40 hours saved per QBU, and $88.50 per hour of tax professional work, the Treasury and the IRS estimate that the proposed regulations would generate approximately $16 million in annual compliance cost savings.

TABLE 1—ESTIMATED ANNUAL COMPLIANCE SAVINGS

Affected QBUs	Hours saved per QBU	Cost per hour	Estimated annual compliance savings (millions)
1,000	20	$88.50	$1.8
4,500	40	88.50	15.9
4,500	60	88.50	23.9

This estimate should be interpreted as an order-of-magnitude estimate rather than a precise measurement. The actual savings will depend on the number of CFCs and QBUs for which taxpayers make the election, the extent of existing section 987 compliance systems, the number and complexity of currencies and disregarded transactions, the frequency of remittances and restructurings, and the amount of residual work required for pre-election section 987 gain or loss and inbound transactions.

3. Effects of Pre-Election Gain or Loss Amortization and the QBU-Level Asset-Based Test

The proposed regulations would require pre-election section 987 gain or loss to be recognized ratably over a 120-month period. This rule applies to taxpayers that make the CFC exemption election after unrecognized section 987 gain or loss has already accrued. It is intended to preserve the tax consequences of currency gain or loss that arose before the election became effective and to prevent asymmetric results under which taxpayers with accrued gains could elect out of section 987(3) and eliminate those gains, while taxpayers with accrued losses could preserve or accelerate those losses.

The 120-month period also smooths the transition into the CFC exemption election. Relative to immediate recognition, ratable recognition reduces

[5] Alternative methodologies introduced in subsequent guidance are likely to entail lower compliance costs relative to the 2016 section 987 regulations.

[6] The proposed regulations include a mandatory asset-based test that would exempt taxpayers from calculating pre-election gain or loss pool for QBUs with less than $50 million in assets.

[7] Some taxpayers may decline to make the CFC exemption election. One reason may be that the CFC exemption election would apply consistently across commonly controlled CFCs and could be revoked only with the consent of the Commissioner. These limitations may reduce the value of the CFC exemption election for taxpayers that expect their structures, currency exposures, or planning needs to change in the future and therefore prefer flexibility across CFCs, QBUs, or taxable years. Another reason may be that the election does not eliminate all section 987-related compliance obligations: section 987(1) and (2) would continue to apply, and special rules would require recognition of section 987 gain in certain inbound nonrecognition transactions to prevent excess asset basis attributable to exchange-rate fluctuations from escaping U.S. tax.

the likelihood that making the election would produce a large one-year tax effect for taxpayers with substantial pre-election section 987 gain. Similarly, taxpayers with substantial pre-election section 987 loss would not receive an immediate deduction for the full amount. This treatment reduces the extent to which the election itself creates a timing benefit or cost unrelated to current business operations.

Using months rather than taxable years also avoids acceleration in short taxable years. For a taxpayer with full 12-month taxable years, a 120-month period generally produces the same annual recognition pattern as a 10-year period. For a taxpayer with a one-month short taxable year, however, the monthly rule would require recognition of 1/120th of the relevant amount rather than one-tenth. This reduces the extent to which the occurrence or timing of a short taxable year affects the tax consequences of entering the election.

The proposed regulations would also include a mandatory QBU-level asset-based test intended to reduce transition burden for smaller QBUs. Under this test, a QBU with average assets of less than $50 million for the three-year period preceding the election would not be required to compute or recognize pre-election unrecognized section 987 gain or loss in connection with the CFC exemption election. Because reconstructing historical or pretransition section 987 pools may involve fixed costs per QBU, the test is expected to reduce entry costs for smaller QBUs for which those fixed costs may be large relative to the expected future compliance savings from the election.

Based on Form 8858 returns for tax year 2021, the Treasury Department and the IRS estimate that a $50 million threshold would exempt about 75 percent of section 987 QBUs from calculating pre-election pools, while excluding less than 5 percent of reported QBU assets. Thus, the test would provide broad compliance relief by QBU count while retaining the transition rules for larger QBUs, where the potential tax consequences are more likely to be material.

For QBUs above the asset threshold, taxpayers making the election would need to compute pre-election section 987 gain or loss and track the recognized and remaining unrecognized amounts over the 120-month period.[8] These costs are likely to be greatest for taxpayers that make the CFC exemption election after the transition date, taxpayers with multiple CFC-owned section 987 QBUs, taxpayers with outstanding deferred section 987 gain or loss or cumulative suspended section 987 loss, and taxpayers that own section 987 QBUs through partnerships. These costs are transitional and targeted; they are linked to preserving pre-election amounts while the CFC exemption election generally reduces ongoing section 987(3) computations for ordinary CFC branch operations after the election takes effect.

Overall, the 120-month amortization rule and the QBU-level asset-based test are expected to make the CFC exemption election more administrable while limiting selective tax effects from accrued section 987 positions. The amortization rule preserves pre-election amounts and reduces incentives to time the election to eliminate gains or accelerate losses. The asset-based test reduces the principal transition cost for smaller QBUs—the need to compute historical or pre-election section 987 pools—while retaining the transition rules for QBUs for which the potential tax consequences are more likely to be material.

4. Effects of the Inbound Transaction Rules

The proposed regulations include special rules for certain inbound nonrecognition transactions involving exempt CFCs. These rules are intended to prevent exchange-rate-driven increases in asset basis from being imported into the United States without corresponding gain recognition. Without these rules, a CFC exemption election could reduce the compliance burden for ordinary CFC branch operations but also create an opportunity for untaxed section 987 currency gain to be reflected in the basis of assets transferred to a domestic corporation in an inbound liquidation or reorganization. That imported basis could then reduce U.S. taxable income through depreciation, amortization, gain reduction, or loss recognition in later years.

The economic effect of these rules is expected to be targeted. The rules apply only when assets of an exempt CFC are acquired in an inbound nonrecognition transaction, rather than to ordinary-course remittances or ongoing CFC branch operations. In addition, the gain-recognition rule generally approximates the treatment that would apply if the CFC exemption election were not in effect, because the 2024 final regulations generally treat section 987 QBUs owned by a CFC as terminated immediately before an inbound nonrecognition transaction and require recognition of any net unrecognized section 987 gain at that time. Thus, relative to the baseline, the inbound transaction rules principally prevent the CFC exemption election from changing the treatment of a targeted class of restructuring transactions in a way that could allow excess asset basis to enter the U.S. tax system.

The proposed regulations would require recognition of section 987 gain based on two alternative methods for determining section 987 asset basis. These methods are intended to serve as administrable proxies that reduce the need for full historical section 987 computations while preserving gain recognition in transactions where the basis-importation concern is most significant. The first methodology would generally use a six-year lookback computation of net unrecognized section 987 gain, while the second methodology would use excess asset basis concepts under section 367(b). These alternatives may reduce compliance costs by allowing taxpayers to use the method that is more administrable in their circumstances, although either method may be imprecise for some taxpayers. The proposed regulations also include a de minimis rule, which reduces compliance burden for smaller inbound transactions of CFCs with less than $25 million in assets, where any potential basis-importation concern is less likely to be economically significant.

Consistent with the 2024 final regulations' treatment of suspended section 987 losses in inbound nonrecognition transactions, the proposed regulations would not provide a special rule allowing an exempt CFC to recognize section 987 loss in an inbound transaction. This asymmetric treatment may deny loss recognition in some cases, but it reduces the risk that taxpayers could selectively enter into elective inbound transactions to trigger foreign currency losses. This approach is also consistent with the longstanding treatment of inbound nonrecognition transactions under section 367(b), which does not permit the recognition of a deduction or loss.

For these reasons, the inbound transaction rules are expected to have limited effects on ordinary business operations and investment decisions, while reducing opportunities for tax-motivated basis importation in a narrow class of transactions.

[8] The Treasury Department and the IRS expect most taxpayers transitioning to the 2024 final regulations generally will have incurred those same costs for all of their QBUs in deciding whether to make the 10-year amortization election under the 2024 final regulations. Therefore, the CFC exemption election is unlikely to create a new burden for these taxpayers.

5. Effects of Consistency and Anti-Avoidance Requirements

The proposed regulations require the CFC exemption election to be made consistently for commonly controlled CFCs and include anti-avoidance rules for related-party transactions designed to avoid those consistency requirements or produce inappropriate deemed revocations. These rules are intended to reduce selective use of the election. In particular, they limit the ability of a taxpayer group to apply the CFC exemption election selectively for tax-motivated reasons. This helps ensure that the election functions as a simplification rule, rather than as a tool for one-sided gain avoidance or loss preservation.

The consistency requirements may reduce flexibility for taxpayers with CFCs that have different section 987 profiles. A taxpayer may have some CFCs with expected section 987 gains and others with expected section 987 losses, or some CFCs with relatively simple branch operations and others with more complex currency exposures. A consistent election rule may therefore cause some taxpayers to forgo the election, especially if the taxpayer values flexibility to recognize losses under the baseline rules or is uncertain about future currency movements, acquisitions, dispositions, or restructurings. The constraint is targeted, however: taxpayers remain able to choose whether to make the election, and the rules primarily limit selective use of the election within commonly controlled groups, where the potential for tax-motivated sorting is greatest.

Absent consistency requirements, taxpayers would have stronger incentives to organize CFC ownership and branch structures around expected section 987 outcomes. A taxpayer could elect exempt treatment for CFCs with built-in or expected section 987 gains while declining the election for CFCs with built-in or expected section 987 losses, producing one-sided results across CFCs that are economically part of the same multinational group. The rules also reduce incentives to alter ownership chains, branch structures, or related-party transactions to separate gain-producing and loss-producing section 987 QBUs into different election groups. By requiring the taxpayer to evaluate the election across its commonly controlled CFC structure, the rules reduce the extent to which tax outcomes depend on formal ownership structure rather than underlying economic activity.

The anti-avoidance rules reinforce the consistency requirements by addressing controlled-group transactions undertaken with a principal purpose of avoiding the requirement to make the CFC exemption election, causing an inappropriate deemed revocation, or causing a partnership to cease to be an exempt partnership. These rules reduce the value of related-party restructuring designed to change election status without a corresponding change in the group's economic position. As a result, they are expected to preserve the compliance-cost reduction objective of the election while limiting the use of related-party transactions to obtain one-sided section 987 outcomes.

Overall, the consistency and anti-avoidance requirements are expected to improve the integrity and administrability of the CFC exemption election. Although they may reduce election uptake at the margin, they also reduce opportunities for selective gain avoidance and loss recognition, limit incentives for tax-motivated restructuring, and promote more consistent treatment among taxpayer groups with similar CFC branch operations and common control relationships.

6. Summary

Overall, the proposed regulations are expected to be taxpayer-favorable and burden-reducing relative to the 2024 final regulations. The principal economic effects are expected to be reduced annual compliance costs of approximately $16 million, greater certainty for return preparation, reduced administrative burden, and targeted protection against basis importation in inbound nonrecognition transactions. The Treasury Department and the IRS invite public comments and additional data on the economic effects that would result from these proposed regulations.

II. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) (PRA) requires that a Federal agency obtain the approval of the Office of Management and Budget (OMB) before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the OMB.

The collection of information in the proposed regulations is in proposed § 1.987–1(g)(3). The likely respondents are U.S. shareholders of CFCs that own section 987 QBUs.

The collection of information in proposed § 1.987–1(g)(3) is required only when a taxpayer makes or revokes a CFC exemption election under proposed § 1.987–15. In general, taxpayers can make a CFC exemption election without the Commissioner's consent, but consent is required to revoke the election. The Commissioner's consent may be granted with a private letter ruling. When a taxpayer makes or revokes a CFC exemption election, the collection of information is mandatory. The collection of information required by proposed § 1.987–1(g)(3) will be used by the IRS for tax compliance purposes.

The Treasury Department and the IRS intend that the information described in proposed § 1.987–1(g)(3) will be collected by attaching a statement to Form 8964–ELE. For purposes of the PRA, the reporting burden associated with those collections of information will be reflected in the PRA submissions associated with Form 8964–ELE. The OMB Control Number for Form 8964–ELE will be included within 1545–0123 for business filers, 1545–0074 for individual filers, and 1545–0092 for trust and estate filers in accordance with the PRA procedures under 5 CFR 1320.10.

To the extent that a taxpayer makes or revokes an election by obtaining a private letter ruling, the reporting burden associated with those collections of information will be reflected in the PRA submissions associated with revenue procedures governing private letter rulings. The OMB Control Number for those revenue procedures is control number 1545–1522. The proposed regulations would require taxpayers merely to follow the procedures under Revenue Procedure 2026–1, IRB 2026–1 (or future revenue procedures governing private letter rulings) and would not change the collection requirements of the Revenue Procedure.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act.

The proposed regulations affect U.S. shareholders of CFCs with foreign branch operations. The number of small entities potentially affected by the proposed regulations is unknown; however, it is unlikely to be a substantial number because taxpayers that are U.S. shareholders of CFCs are typically larger businesses. The Treasury Department and the IRS estimate that the total number of entities that own a CFC with a foreign branch subject to section 987 is approximately 1,500 (many of which may not make the CFC exemption election). This estimate is based on the number of corporations and partnerships that filed a Form 8858 in 2023 that showed that the filer: (1) owned at least one disregarded entity or branch with a functional currency different from the functional currency of the owner, (2) indicated that the disregarded entity or branch was a section 989 QBU, and (3) indicated that the disregarded entity or branch was owned by a CFC. As shown in the following table, only a small percentage of those filers are small entities.

Total receipts/positive income (2023)	Percentage of filers
Under $10 Million	12
$10 Million to $25 Million	5
$25 Million to $50 Million	4
Over $50 Million	79

A portion of the economic impact of the proposed regulations may derive from the collection of information requirements imposed under proposed § 1.987–1(g)(3). The Treasury Department and the IRS have determined that the average burden is 1.95 hours per response. The IRS's Research, Applied Analytics, and Statistics division estimates that the appropriate wage rate for this set of taxpayers is $88.50 per hour. Thus, the annual burden per taxpayer from each collection of information requirement is $172.60.

IV. Section 7805(f)

Pursuant to section 7805(f) of the Code, this proposed regulation will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

V. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. The proposed regulations do not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

VI. Executive Order 13132: Federalism

Executive Order 13132 (entitled ''Federalism'') prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. The proposed regulations do not have federalism implications and do not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this document are published in the Internal Revenue Bulletin or Cumulative Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *https://www.irs.gov.*

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all other aspects of the proposed regulations. Any comments submitted will be made available at *https://www.regulations.gov* or upon request. Pursuant to the Administrative Procedure Act at 5 U.S.C. 553(b)(4), a plain language summary of the proposed rule is also available at *https://www.regulations.gov.*

A public hearing concerning the proposed regulations will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these proposed regulations are Raphael J. Cohen and Mark T. Terrell of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Adoption of Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

■ **Par. 2.** Section 1.367(b)–3 is amended by:

■ 1. Revising the introductory text of paragraph (g)(2)(i); and

■ 2. Adding a sentence to the end of paragraph (g)(7)(i).

The revisions and addition read as follows:

§ 1.367(b)–3 Repatriation of foreign corporate assets in certain nonrecognition transactions.

* * * * *

(g) * * *

(2) * * *

(i) *Excess asset basis.* The term *excess asset basis* means, with respect to a foreign acquired corporation, the amount (determined after the application of § 1.987–16(d)) by which the inside asset basis of that corporation exceeds the sum of the following amounts:

* * * * *

(7) * * *

(i) * * * Paragraph (g)(2)(i) of this section, to the extent it relates to the application of § 1.987–16(d), applies to transactions completed within taxable years of the domestic acquiring corporation ending on or after [date of filing of final regulations with the **Federal Register**].

* * * * *

■ **Par. 3.** Section 1.987–1 is amended by:

■ 1. In paragraph (a):

■ a. In the first sentence, removing the language ''1.987–15'' and adding the language ''1.987–17'' in its place;

■ b. Revising the current last sentence of the paragraph and adding two sentences to the end of the paragraph;
■ 2. In paragraph (g):
■ a. Adding paragraphs (g)(2)(iv) and (v);
■ b. Revising the first sentence of paragraph (g)(3)(ii)(A); and
■ c. Adding paragraph (g)(3)(ii)(D).
■ 3. In paragraph (h), adding definitions for ''CFC exemption election'', ''Domestic acquiring corporation,'' ''Exempt CFC'', ''Exempt partnership'', ''Exempt partnership QBU'', ''Inbound nonrecognition transaction'', ''Pre-election section 987 gain or loss'', ''Pre-transaction period'', ''Pre-transaction taxable year,'' and ''transferor CFC'' in alphabetical order.

The revisions and additions read as follows:

§ 1.987–1 Scope, definitions, and special rules.

(a) * * * Section 1.987–15 provides rules relating to the CFC exemption election. Section 1.987–16 provides rules that apply to an inbound liquidation or reorganization of a CFC that was subject to the CFC exemption election. Section 1.987–17 provides the applicability date of the section 987 regulations.

* * * * *

(g) * * *

(2) * * *

(iv) *Commissioner consent.* An election is not deemed to be made or revoked under this paragraph (g)(2) or § 1.987–15(c) if the authorized person requests and receives consent from the Commissioner (as described in paragraph (g)(3)(ii)(A) of this section) to not make or to not revoke the election, as applicable.

(v) *CFC exemption election. See* § 1.987–15(c) for additional rules that apply with respect to the CFC exemption election.

(3) * * *

(ii) * * *

(A) * * * Except as provided in paragraph (g)(3)(ii)(B), (C), or (D) of this section, a section 987 election may not be made or revoked without the consent of the Commissioner. * * *

* * * * *

(D) *CFC exemption election*—(*1*) *Taxable years beginning after December 31, 2024 and ending on or before December 31, 2026.* For a taxable year beginning after December 31, 2024, and ending on or before December 31, 2026, the authorized person may make a CFC exemption election without the Commissioner's consent by attaching the election statement described in paragraph (g)(3)(i) of this section to its original, timely filed (including extensions) return for such taxable year, in accordance with the prescribed form or its instructions (or other guidance). In addition, for a taxable year beginning in 2025, the authorized person may make a CFC exemption election without the Commissioner's consent by attaching the election statement described in paragraph (g)(3)(i) of this section to an amended return for such taxable year filed on or before October 15, 2027, in accordance with the prescribed form or its instructions (or other guidance).

(*2*) *Taxable years ending in 2027.* For a taxable year ending in 2027 (other than a taxable year to which paragraph (g)(3)(ii)(D)(*4*) of this section applies), the authorized person may make a CFC exemption election without the Commissioner's consent by filing the statement described in paragraph (g)(3)(i) of this section with the Internal Revenue Service in accordance with the prescribed form or its instructions (or other guidance) on or before October 15, 2027, and attaching a copy of the statement to its return for such taxable year.

(*3*) *Taxable years ending after December 31, 2027.* For a taxable year ending after December 31, 2027 (other than a taxable year to which paragraph (g)(3)(ii)(D)(*4*) of this section applies), the authorized person may make a CFC exemption election without the Commissioner's consent by filing the statement described in paragraph (g)(3)(i) of this section with the Internal Revenue Service in accordance with the prescribed form or its instructions (or other guidance) on or before the first day of the taxable year to which the election applies, and attaching a copy of the statement to its return for such taxable year.

(*4*) *Taxable year in which election first becomes relevant.* For the taxable year in which the CFC exemption election first becomes relevant, the authorized person may make a CFC exemption election without the Commissioner's consent by attaching the election statement described in paragraph (g)(3)(i) of this section to its original, timely filed (including extensions) return for such taxable year, in accordance with the prescribed form or its instructions (or other guidance). For this purpose, the CFC exemption election first becomes relevant with respect to an authorized person in the first taxable year of the authorized person beginning after December 31, 2024, in which a CFC that is the owner of a section 987 QBU is part of the authorized person's section 987 electing group.

* * * * *

(h) * * *

* * * * *

CFC exemption election. CFC exemption election has the meaning provided in § 1.987–15(a).

* * * * *

Domestic acquiring corporation. Domestic acquiring corporation has the meaning provided in § 1.987–16(b).

* * * * *

Exempt CFC. Exempt CFC has the meaning provided in § 1.987–15(a).

Exempt partnership. Exempt partnership has the meaning provided in § 1.987–7(b)(2)(iv).

Exempt partnership QBU. Exempt partnership QBU has the meaning provided in § 1.987–7(b)(2)(iii).

* * * * *

Inbound nonrecognition transaction. Inbound nonrecognition transaction has the meaning provided in § 1.987–16(b).

* * * * *

Pre-election section 987 gain or loss. Pre-election section 987 gain or loss has the meaning provided in § 1.987–15(e)(2).

Pre-transaction period. Pre-transaction period has the meaning provided in § 1.987–16(b)(2).

Pre-transaction taxable year. Pre-transaction taxable year has the meaning provided in § 1.987–16(c)(2)(ii).

* * * * *

Transferor CFC. Transferor CFC has the meaning provided in § 1.987–16(b).

* * * * *

■ **Par. 4.** Section 1.987–6 is amended by adding paragraphs (b)(1)(v) and (vi) to read as follows:

§ 1.987–6 Character and source of section 987 gain or loss.

* * * * *

(b) * * *

(1) * * *

(v) In the case of net unrecognized section 987 gain or loss that is recognized as pre-election section 987 gain or loss under § 1.987–15(e)(3), the taxable year immediately preceding the first taxable year in which the CFC exemption election applies.

(vi) The taxable year in which the amount of section 987 asset basis is recognized under § 1.987–16(d).

* * * * *

■ **Par. 5.** Section 1.987–7 is amended by:
■ 1. Revising paragraph (b);
■ 2. In paragraph (c)(2)(i), removing the language ''1.987–15'' and adding the language ''1.987–17'' in its place; and
■ 3. Adding paragraphs (c)(2)(iv) and (d)(2)(iv).

The revisions and additions read as follows:

§ 1.987–7 Application of the section 987 regulations to partnerships and S corporations.

* * * * *

(b) *Section 987 regulations generally do not apply to partnerships*—(1) *In general.* Except as otherwise provided in this section, the section 987 regulations do not apply to a partnership, and the section 987 regulations do not apply to an eligible QBU if a partnership is the direct owner of the eligible QBU.

(2) *Application of section 987 and section 989(a).* In general, a taxpayer must apply sections 987 and 989(a) to partnerships and eligible QBUs directly owned by partnerships in a reasonable manner. However, in the case of an exempt partnership QBU, section 987(3) applies only to the extent provided in §§ 1.987–15 and 1.987–16.

(i) *Consistency.* In applying sections 987 and 989(a) with respect to a partnership or an eligible QBU directly owned by a partnership, taxpayers must use the same method consistently from year to year with respect to a particular partnership or eligible QBU. In addition, all members of the same controlled group must apply the same method consistently with respect to a particular partnership or eligible QBU.

(ii) *Tiered partnerships.* For purposes of the section 987 regulations, a taxpayer that owns an interest in a partnership (*lower-tier partnership*) indirectly through one or more other partnerships is treated as a partner in the lower-tier partnership.

(iii) *Exempt partnership QBU.* For purposes of the section 987 regulations, an *exempt partnership QBU* is a partnership (or an interest in the partnership) or an eligible QBU directly owned by a partnership, if the taxpayer applies sections 987 and 989(a) using a method under which—

(A) The partnership, interest in the partnership, or eligible QBU is a section 987 QBU; and

(B) The owner of the section 987 QBU is either an exempt CFC or an exempt partnership.

(iv) *Exempt partnership.* For purposes of the section 987 regulations, an *exempt partnership* is a partnership in which at least 80 percent of the capital or profits interests are owned (directly or indirectly through other partnerships) by exempt CFCs that are members of the same controlled group on the last day of the partnership's taxable year.

(c) * * *

(2) * * *

(iv) *Rules relating to the CFC exemption election*—(A) *In general.* Sections 1.987–15 and 1.987–16 apply to an exempt partnership QBU.

(B) *Certain rules not applicable to exempt partnership QBUs.* Notwithstanding paragraphs (c)(2)(i) and (ii) of this section, §§ 1.987–6 and 1.987–11 through 1.987–13 do not apply to an exempt partnership QBU (except to the extent provided in §§ 1.987–15 and 1.987–16), and an annual recognition election does not apply to an exempt partnership QBU.

* * * * *

(d) * * *

(2) * * *

(iv) *Exempt partnership QBU.* Paragraph (d)(1)(ii) of this section does not apply to an exempt partnership QBU.

* * * * *

■ **Par. 6.** Section 1.987–10 is amended by:

■ 1. In paragraph (c)(1), removing the language "1.987–15(a)(1)" and adding the language "1.987–17(a)(1)" in its place;

■ 2. Revising paragraph (e)(5)(ii)(A) and the last sentence of paragraph (e)(5)(ii)(C); and

■ 3. Adding paragraph (e)(5)(ii)(D).

The revisions and addition read as follows:

§ 1.987–10 Transition rules.

* * * * *

(e) * * *

(5) * * *

(ii) * * *

(A) *In general.* A taxpayer may elect to recognize pretransition gain or loss ratably over the transition period. If an election is made to recognize pretransition gain or loss ratably over the transition period, then paragraph (e)(5)(i) of this section does not apply, and each owner to which the election applies recognizes its pretransition gain or loss with respect to each section 987 QBU, original deferral QBU, and outbound loss QBU ratably over a period of 120 months beginning with the first month of the taxable year that begins on the transition date described in paragraph (c)(1) of this section. *See* § 1.987–1(g) for rules relating to section 987 elections (including consistency rules).

* * * * *

(C) * * * The pretransition gain or loss is recognized ratably over a period of 120 months beginning with the first month of the taxable year that begins on the transition date described in paragraph (c)(1) of this section.

(D) *Amounts previously recognized under ten-year amortization rule.* For purposes of this paragraph (e)(5)(ii), if an owner recognized a ratable portion of its pretransition gain or loss in one or more taxable years under § 1.987–10(e)(5)(ii)(A) or (C), as contained in 26 CFR in part 1 in effect on April 1, 2025, each such taxable year is deemed to contain twelve months. Thus, for example, if the first taxable year of an owner in which the section 987 regulations apply is a short taxable year lasting one month, and the owner recognized one tenth of its pretransition gain or loss in that taxable year under § 1.987–10(e)(5)(ii)(A) or (C), as contained in 26 CFR in part 1 in effect on April 1, 2025, the owner recognizes its remaining pretransition gain or loss ratably over 108 months beginning with the first month of the next taxable year.

* * * * *

■ **Par. 7.** Section 1.987–15 is redesignated as § 1.987–17 and new § 1.987–15 is added to read as follows:

§ 1.987–15 CFC exemption election.

(a) *Overview.* This section provides rules for an election (*CFC exemption election*) under which section 987(3) applies to a CFC only to the extent provided in this section and § 1.987–16. Paragraph (b) of this section provides rules regarding the effect of making a CFC exemption election. Paragraph (c) of this section provides consistency requirements for making the election. Paragraph (d) of this section provides rules for coordinating the CFC exemption election with the transition rules of § 1.987–10. Paragraph (e) of this section provides rules under which a CFC that is subject to the CFC exemption election (an *exempt CFC*) must account for pre-election section 987 gain or loss. Paragraph (f) of this section provides rules that apply if a CFC exemption election is revoked. Paragraph (g) of this section provides rules for applying this section with respect to a partnership. Paragraph (h) of this section provides examples that illustrate the application of the rules of this section.

(b) *Effect of CFC exemption election*—(1) *In general.* Except as otherwise provided in this section or § 1.987–16, section 987(3) does not apply to an exempt CFC. In addition, the rules of the section 987 regulations apply to an exempt CFC only to the extent provided in this section or § 1.987–16. *See* § 1.987–7(b)(2), (c)(2)(iv), and (d)(2)(iv) for rules relating to the effect of a CFC exemption election on partnerships and eligible QBUs directly owned by partnerships.

(2) *Applicable provisions.* The rules of this section, and the rules of the section 987 regulations listed in this paragraph (b)(2), apply to an exempt CFC, subject to the modifications described in paragraph (b)(3) of this section.

(i) Section 1.987–1 (scope, definitions, and special rules);

(ii) Section 1.987–2 (attribution of items to eligible QBUs and other rules);

(iii) Section 1.987–3 (determination of section 987 taxable income or loss);

(iv) Section 1.987–5(f) (determination of the owner's adjusted basis in transferred assets and the amount of transferred liabilities);

(v) Section 1.987–7 (rules relating to partnerships);

(vi) Section 1.987–8 (QBU terminations), subject to the modifications described in paragraph (b)(3)(ii) of this section;

(vii) Section 1.987–9 (recordkeeping requirements), subject to the modifications described in paragraph (b)(3)(iii) of this section;

(viii) Section 1.987–10 (transition rules), including the application (for purposes of § 1.987–10) of rules cross-referenced in § 1.987–10;

(ix) Section 1.987–16 (inbound nonrecognition transactions involving an exempt CFC); and

(x) Section 1.987–17 (applicability dates).

(3) *Modifications to applicable provisions*—(i) *Current rate election.* With respect to an exempt CFC, the rules described in paragraph (b)(2) of this section are applied as if a current rate election were in effect.

(ii) *QBU terminations.* An exempt CFC does not recognize section 987 gain or loss under § 1.987–8(e) when a section 987 QBU terminates.

(iii) *Recordkeeping requirements.* With respect to an exempt CFC, the recordkeeping requirements set forth in § 1.987–9(b)(2), (b)(4) through (12), and (b)(14) do not apply. A taxpayer must retain the records necessary to substantiate the determinations required under this section and § 1.987–16, including the records needed to support the chosen methodology for computing section 987 asset basis under § 1.987–16(c).

(iv) *Partnerships. See* § 1.987–7(c)(2) for the rules that apply to an exempt partnership QBU.

(c) *Consistency requirements*—(1) *In general.* The consistency rules of § 1.987–1(g)(2) apply with respect to a CFC exemption election, subject to the modifications described in paragraph (c)(2) of this section and the anti-avoidance rule provided in paragraph (c)(3) of this section.

(2) *Modifications*—(i) *Affiliates treated as a single United States person.* All domestic corporations that are affiliates described in § 1.904(i)–1(b) on the last day of the taxable year described in § 1.904(i)–1(c) are treated as a single United States person. Thus, in applying § 1.987–1(g)(2)(ii) for purposes of the CFC exemption election, all such domestic corporations are part of the same section 987 electing group.

(ii) *Ownership through domestic partnerships.* For purposes of determining whether a United States person (other than a partnership) owns stock of a CFC within the meaning of section 958(a), stock of a foreign corporation owned by a domestic partnership is treated in the same manner as stock of a foreign corporation owned by a foreign partnership.

(3) *Anti-avoidance rule*—(i) *In general*—(A) *No deemed revocation.* Notwithstanding the rules of § 1.987–1(g)(2), if a transaction involving two or more members of the same controlled group is entered into with a principal purpose of causing a deemed revocation of a CFC exemption election under § 1.987–1(g)(2) or otherwise causing a CFC exemption election to cease to be effective, the CFC exemption election is not deemed to be revoked and remains in effect.

(B) *Deemed election.* If a transaction involving two or more members of the same controlled group is entered into with a principal purpose of avoiding the requirement to make a CFC exemption election with respect to one or more CFCs under § 1.987–1(g)(2) and paragraph (c)(2) of this section, the CFC exemption election is deemed to be made with respect to those CFCs.

(C) *Exempt partnerships.* If a transaction involving two or more members of the same controlled group is entered into with a principal purpose of causing an exempt partnership to cease to be an exempt partnership, the CFC exemption election is deemed to be made with respect to any CFC that is a partner in the partnership and is a member of the controlled group.

(ii) *Subsequent application of the consistency rule.* If a CFC is subject to a deemed CFC exemption election under paragraph (c)(3)(i) of this section, the CFC exemption election is also deemed to be made with respect to the other members of the CFC's section 987 electing group.

(d) *Coordination with transition rules provided in § 1.987–10*—(1) *Deemed election to recognize pretransition gain or loss ratably over the transition period*—(i) *In general.* If a CFC exemption election is made for the taxable year beginning on the transition date described in § 1.987–10(c)(1), the election to recognize pretransition gain or loss ratably over the transition period under § 1.987–10(e)(5)(ii) is deemed to be made with respect to each CFC for which the CFC exemption election is made.

(ii) *Consistency rules.* Notwithstanding the rules of § 1.987–1(g)(2), the election described in § 1.987–10(e)(5)(ii) is not required to be made with respect to the members of an exempt CFC's section 987 electing group (other than exempt CFCs) solely by reason of a deemed election described in paragraph (d)(1)(i) of this section.

(2) *Pretransition gain or loss with respect to QBUs that hold assets of less than $50 million.* Notwithstanding the rules of § 1.987–10, if a CFC exemption election is made for the taxable year beginning on the transition date described in § 1.987–10(c)(1), an exempt CFC is treated as having no pretransition gain or loss with respect to any QBU described in paragraph (e)(2)(iii)(B) of this section.

(e) *Election made in a subsequent taxable year*—(1) *In general.* This paragraph (e) provides rules under which an exempt CFC must compute and recognize pre-election section 987 gain or loss if the CFC exemption election is made for a taxable year other than the taxable year beginning on the transition date described in § 1.987–10(c)(1) (or, in the case of a QBU described in § 1.987–10(f)(1), if the election is made for any taxable year).

(2) *Computation of pre-election section 987 gain or loss*—(i) *In general.* Except as provided in paragraph (e)(2)(ii) or (iii) of this section, an exempt CFC's *pre-election section 987 gain or loss* with respect to a section 987 QBU, successor deferral QBU, or successor suspended loss QBU is equal to—

(A) The exempt CFC's net unrecognized section 987 gain or loss (as determined under § 1.987–4) with respect to a section 987 QBU for the taxable year immediately preceding the first taxable year in which the CFC exemption election applies, reduced by the amount of the net unrecognized section 987 gain or loss that is recognized, suspended, or deferred in the preceding taxable year;

(B) The exempt CFC's outstanding deferred section 987 gain or loss (as determined under § 1.987–12) with respect to a successor deferral QBU for the taxable year immediately preceding the first taxable year in which the election applies, reduced by the amount of the outstanding deferred section 987 gain or loss that is recognized, suspended, or attributed to a different successor deferral QBU in the preceding taxable year; and

(C) The exempt CFC's cumulative suspended section 987 loss (as determined under § 1.987–11) with respect to a section 987 QBU or successor suspended loss QBU for the taxable year immediately preceding the first taxable year in which the election applies, reduced by the amount of the suspended section 987 loss that is recognized, eliminated, or attributed to a different successor suspended loss QBU in the preceding taxable year. Suspended section 987 loss described in § 1.987–13(e) is not taken into account in determining pre-election section 987 gain or loss.

(ii) *Adjustments required if a current rate election is not in effect for the preceding taxable year.* Except as provided in paragraph (e)(2)(iii) of this section, if a current rate election is not in effect for the taxable year immediately preceding the first taxable year in which the CFC exemption election applies, pre-election section 987 gain or loss with respect to a section 987 QBU is adjusted to account for any change to the owner functional currency net value of the section 987 QBU attributable to the CFC exemption election. The amount of the adjustment is equal to—

(A) The owner functional currency net value of the section 987 QBU, determined under § 1.987–4(e) on the last day of the preceding taxable year as though a current rate election was in effect; minus

(B) The owner functional currency net value of the section 987 QBU, determined under § 1.987–4(e) on the last day of the preceding taxable year based on the elections in effect for the preceding taxable year.

(iii) *Pre-election section 987 gain or loss with respect to QBUs that hold assets of less than $50 million*—(A) *In general.* An exempt CFC is treated as having no pre-election section 987 gain or loss with respect to a section 987 QBU, successor deferral QBU, or successor suspended loss QBU described in paragraph (e)(2)(iii)(B) of this section.

(B) *QBUs that hold assets of less than $50 million*—(*1*) *In general.* A QBU is described in this paragraph (e)(2)(iii)(B) if the average amount of the QBU's assets for the last three taxable years before the first taxable year in which the CFC exemption election applies is less than $50 million. Any taxable year in which a QBU did not exist is not taken into account in computing the average amount of the QBU's assets for purposes of this paragraph (e)(2)(iii)(B).

(*2*) *Amount of assets.* For purposes of this paragraph (e)(2)(iii)(B), the amount of a QBU's assets for a taxable year is equal to the amount of total assets reflected on the QBU's balance sheet in accordance with generally accepted accounting principles on the last day of the taxable year (without regard to whether the assets are properly attributable to the QBU under § 1.987–2 and without adjustment to conform to federal income tax principles).

(*3*) *Aggregation rule.* All section 987 QBUs, successor deferral QBUs, and successor suspended loss QBUs of an exempt CFC that have the same country of residence (as defined in section 988(a)(3)(B)) are treated as a single QBU for purposes of this paragraph (e)(2)(iii).

(3) *Recognition of pre-election section 987 gain or loss*—(i) *In general.* An exempt CFC's pre-election section 987 gain or loss is recognized ratably over a period of 120 months under the rules of § 1.987–10(e)(5)(ii) (treating pre-election section 987 gain or loss in the same manner as pretransition gain or loss), subject to the modifications described in this paragraph (e)(3).

(ii) *Transition date.* In applying § 1.987–10(e)(5)(ii) with respect to pre-election section 987 gain or loss, the first taxable year in which a CFC exemption election applies is treated as the taxable year beginning on the transition date described in § 1.987–10(c)(1). Thus, in general, pre-election section 987 gain or loss is recognized ratably over a period of 120 months beginning with the first month of the first taxable year in which the CFC exemption election applies.

(iii) *Source and character*—(A) *Net unrecognized section 987 gain or loss.* The source and character of net unrecognized section 987 gain or loss that is recognized as pre-election section 987 gain or loss under this paragraph (e)(3) is determined under § 1.987–6. *See* § 1.987–6(b)(1)(v).

(B) *Deferred section 987 gain or loss and suspended section 987 loss.* The source and character of deferred section 987 gain or loss or suspended section 987 loss that is recognized as pre-election section 987 gain or loss under this paragraph (e)(3) is the same as the source and character determined under § 1.987–6 in the taxable year of deferral or suspension. *See* § 1.987–6(b)(1)(ii) and (iii).

(iv) *QBU ceases to be owned by a member of the exempt CFC's controlled group*—(A) *Scope.* This paragraph (e)(3)(iv) applies if pre-election section 987 loss of an exempt CFC is computed under paragraph (e)(2) of this section with respect to a section 987 QBU, successor deferral QBU, or successor suspended loss QBU, and, as result of a direct or indirect transfer, or an issuance or redemption, of an ownership interest in the exempt CFC during the 120-month period described in paragraph (e)(3)(i) of this section, the exempt CFC ceases to be a member of the same controlled group as the direct owner of the QBU (or the QBU's successor, determined under the principles of § 1.987–13(b) and (c)). For example, this paragraph (e)(3)(iv) applies if an exempt CFC is sold to an unrelated party, and the exempt CFC has unrecognized pre-election section 987 gain or loss with respect to a QBU that had previously been transferred by the exempt CFC to a member of its controlled group (either before or after the CFC exemption election took effect).

(B) *Pre-election section 987 loss suspended.* In the case of a transaction described in paragraph (e)(3)(iv)(A) of this section, the exempt CFC does not recognize any pre-election section 987 loss with respect to the QBU in the taxable year of the transaction and subsequent taxable years under this paragraph (e)(3). However, the exempt CFC continues to recognize pre-election section 987 gain with respect to the QBU under this paragraph (e)(3). Any pre-election section 987 loss that is not recognized under this paragraph (e)(3)(iv) is treated as suspended section 987 loss of the exempt CFC described in § 1.987–13(e).

(f) *First taxable year in which the election ceases to apply*—(1) *In general.* In the first taxable year in which a CFC exemption election ceases to apply to a CFC, each section 987 QBU of the CFC is deemed to be newly formed on the first day of the taxable year, and the assets and liabilities attributable to the section 987 QBU are deemed to be transferred from the owner to the section 987 QBU on that day.

(2) *Unrecognized pre-election section 987 gain or loss*—(i) *In general.* Except as provided in paragraph (e)(3)(iv) or (f)(2)(ii) of this section, if a CFC exemption election ceases to apply to a CFC, the CFC continues to recognize pre-election section 987 gain or loss under paragraph (e)(3) of this section.

(ii) *Revocation within sixty months.* If a CFC exemption election ceases to apply to a CFC within sixty months after the first day of the first taxable year for which the election applied to the CFC, any pre-election section 987 loss of the CFC that was not recognized under paragraph (e)(3) of this section before the taxable year in which the election ceases to apply is treated as suspended section 987 loss and is not recognized by the CFC under paragraph (e)(3) of this section.

(g) *Partnerships.* This paragraph (g) provides rules for applying this section with respect to an exempt partnership QBU.

(1) *Taxable year beginning on the transition date.* An exempt CFC or exempt partnership must compute and recognize pre-election section 987 gain

or loss with respect to an exempt partnership QBU under paragraph (e) of this section regardless of whether the CFC exemption election is made for the taxable year beginning on the transition date described in § 1.987–10(c)(1) or a later taxable year.

(2) *Pre-election section 987 gain or loss.* For purposes of determining pre-election section 987 gain or loss under paragraph (e)(2)(i) of this section, net unrecognized section 987 gain or loss with respect to an exempt partnership QBU is equal to the amount of gain or loss that the owner would recognize under section 987(3) if the exempt partnership QBU terminated on the last day of the preceding taxable year and no section 987 gain or loss was deferred or suspended.

(3) *Exempt partnership*—(i) *In general.* An exempt partnership that is treated as the owner of a section 987 QBU (or is treated as an original deferral QBU owner or an original suspended loss QBU owner) must compute pre-election section 987 gain or loss in the same manner as an exempt CFC.

(ii) *Recognition of pre-election section 987 gain or loss*—(A) *In general.* An exempt partnership does not recognize pre-election section 987 gain or loss under paragraph (e)(3) of this section. Instead, each partner in the exempt partnership (other than a partner that is itself a partnership) treats its share of the exempt partnership's pre-election section 987 gain or loss as pre-election section 987 gain or loss of the partner that is recognized by the partner in accordance with paragraph (e)(3) of this section. *See* § 1.987–7(b)(2)(ii) (treating an indirect partner as a partner for purposes of the section 987 regulations).

(B) *Partner's share of pre-election section 987 gain or loss.* A partner's share of an exempt partnership's pre-election section 987 gain or loss with respect to a QBU is determined based on the amount of section 987 gain or loss with respect to the QBU that would be included in the partner's distributive share of profits or losses if the exempt partnership recognized the entire amount of pre-election section 987 gain or loss in the first taxable year for which the CFC exemption election applies. The principles of section 706(d) apply in making this determination.

(iii) *Partnership becomes an exempt partnership.* In a taxable year in which a partnership becomes an exempt partnership (for example, because 80 percent of the capital or profits interests in the partnership are acquired by an exempt CFC), the rules of this section are applied with respect to the exempt partnership by treating that taxable year as the first taxable year in which the CFC exemption election applies.

(iv) *Partnership ceases to be an exempt partnership.* In a taxable year in which a partnership ceases to be an exempt partnership, the rules of this section are applied with respect to the partnership by treating that taxable year as the first taxable year in which the CFC exemption ceases to apply.

(h) *Examples.* The following examples illustrate the rules of this section. The examples are not intended to illustrate the appropriate determination of any QBU's functional currency.

(1) *Example 1: CFC exemption election*—(i) *Facts.* U.S. Corp is a domestic corporation that uses the calendar year as its taxable year and has the U.S. dollar as its functional currency. U.S. Corp owns 100 percent of the stock of CFC 1, a controlled foreign corporation within the meaning of section 957(a), which has the U.S. dollar as its functional currency. CFC 1 operates Branch, a section 987 QBU which has the euro as its functional currency. Branch held assets of at least $50 million within the meaning of paragraph (e)(2)(iii)(B) of this section for each of the three taxable years preceding Year 1. In Year 1 (a taxable year beginning after the transition date described in § 1.987–10(c)(1)), a current rate election is in effect. As of December 31, Year 1, CFC 1 has net unrecognized section 987 gain of $1,200x with respect to Branch; CFC 1 does not have any outstanding deferred section 987 gain or loss or cumulative suspended section 987 loss. For Year 2, U.S. Corp makes a CFC exemption election with respect to CFC 1. Branch does not make a remittance to U.S. Corp in Year 1. On July 1, Year 2, Branch transfers an asset with a basis of €400x to CFC 1. CFC 1 does not make any transfers to Branch in Year 2. The spot rate on July 1, Year 2, is €1 = $1.10.

(ii) *Analysis*—(A) *Pre-election section 987 gain or loss.* Under paragraph (e)(2) of this section, CFC 1's pre-election section 987 gain or loss with respect to Branch equals a gain of $1,200x (the amount of net unrecognized section 987 gain or loss at the end of Year 1). Under paragraph (e)(3) of this section, CFC 1 must recognize the $1,200x of pre-election section 987 gain ratably over 120 months ($10x per month), beginning on January 1, Year 2. Accordingly, CFC 1 recognizes $120x of pre-election section 987 gain in Year 2 ($10x per month × 12 months).

(B) *Effect of election.* Under paragraph (b) of this section, CFC 1 does not compute or recognize any section 987 gain or loss under § 1.987–5 for Year 2, notwithstanding the transfer of the asset from Branch to CFC 1 on July 1, Year 2. Under paragraph (b)(3)(i) of this section, the applicable rules of the section 987 regulations are applied as if a current rate election was in effect. As a result, the asset transferred from Branch to CFC 1 is treated as a marked item under § 1.987–1(d)(2). Under § 1.987–5(f)(2), CFC 1's basis in the transferred asset is determined by translating its basis (€400x) into dollars at the spot rate applicable on the date of the transfer (€1 = $1.10). Therefore, CFC 1's basis in the asset equals $440x.

(2) *Example 2: Consistency rule*—(i) *Facts.* FP is a foreign partnership which directly owns 100 percent of the stock of US 1 and US 2, each of which is a domestic corporation that uses the calendar year as its taxable year and has the U.S. dollar as its functional currency. US 1 and US 2 are not affiliates within the meaning of § 1.904(i)–1(b). US 1 directly owns 100 percent of the stock of CFC 1, and US 2 directly owns 100 percent of the stock of CFC 2. CFC 1 and CFC 2 are controlled foreign corporations within the meaning of section 957(a). In Year 1, a CFC exemption election is in effect with respect to CFC 1 but not CFC 2. On July 1, Year 1, US 1 sells all of the stock of CFC 1 to US 2 with a principal purpose of causing a deemed revocation of the CFC exemption election with respect to CFC 1.

(ii) *Analysis*—(A) *Application of the general consistency requirement.* Before July 1, Year 1, US 1 and CFC 1 are members of a section 987 electing group within the meaning of § 1.987–1(g)(2) because US 1 owns more than 50 percent of the stock of CFC1. Similarly, because US 2 owns more than 50 percent of the stock of CFC2, US 2 and CFC 2 are members of a section 987 electing group. US 1 and US 2 are not members of the same section 987 electing group because they are not affiliates within the meaning of § 1.904(i)–1(b). However, US 1 and US 2 are members of the same controlled group as defined in § 1.987–1(h). As a result of US 2's acquisition of the stock of CFC 1, CFC 1 becomes a member of the US 2 section 987 electing group. Therefore, unless the anti-avoidance rule in paragraph (c)(3) of this section applies, the CFC exemption election would be deemed to be revoked with respect to CFC 1 as of January 1, Year 1. *See* § 1.987–1(g)(2).

(B) *Anti-avoidance rule.* US 2 acquired the stock of CFC 1 from US 1 with a principal purpose of causing a deemed revocation of the CFC exemption election with respect to CFC 1. Accordingly, under paragraph (c)(3)(i)(A) of this section, the CFC exemption election with respect to CFC 1 remains in effect for Year 1. In addition, under paragraph (c)(3)(ii) of this section, US 2 is deemed to make a CFC exemption election with respect to CFC 2 beginning in Year 1.

■ Par. 8. Section 1.987–16 is added to read as follows:

§ 1.987–16 Special rules for inbound nonrecognition transactions.

(a) *Overview.* This section provides rules relating to inbound nonrecognition transactions. Paragraph (b) of this section describes the scope of this section's application. Paragraphs (c) and (d) of this section provide rules for, respectively, computing and recognizing the amount of a transferor CFC's section 987 asset basis with respect to an inbound nonrecognition transaction. Paragraph (e) of this section provides a de minimis rule. Paragraph (f) of this section provides an example that illustrates the application of the rules of this section.

(b) *Scope*—(1) *In general.* This section applies if a domestic corporation (the *domestic acquiring corporation*) acquires the assets of a CFC (the *transferor CFC*) in either a liquidation described in section 332 or an asset acquisition described in section 368(a)(1) (an *inbound nonrecognition transaction*), and the transferor CFC was subject to a CFC exemption election for any taxable year ending during the pre-transaction period described in paragraph (b)(2) of this section. For purposes of this section, references to the transferor CFC include any CFC that transferred its assets to the transferor CFC in a transaction described in section 381(a) during the pre-transaction period.

(2) *Pre-transaction period.* For purposes of this section, the *pre-transaction period* is the period beginning 72 months before the inbound nonrecognition transaction and ending on the date of the inbound nonrecognition transaction.

(c) *Computation of section 987 asset basis*—(1) *Choice of methodology.* A transferor CFC is required to compute the amount of its section 987 asset basis under either the lookback methodology described in paragraph (c)(2) of this section or the excess asset basis methodology described in paragraph (c)(3) of this section. The same methodology must be applied with respect to all inbound nonrecognition transactions entered into as part of the same plan or arrangement. The amount of section 987 asset basis computed under this paragraph (c) cannot be less than zero.

(2) *Lookback methodology*—(i) *In general.* If a taxpayer uses the methodology described in this paragraph (c)(2), a transferor CFC's section 987 asset basis is equal to the sum of the transferor CFC's annual unrecognized section 987 gain or loss determined under § 1.987–10(e)(3)(iii) (or, if applicable, under paragraph (c)(2)(iv) of this section) for each pre-transaction taxable year described in paragraph (c)(2)(ii) of this section with respect to each section 987 QBU described in paragraph (c)(2)(iii) of this section. Paragraph (c)(2)(v) of this section provides rules for computing a transferor CFC's section 987 asset basis with respect to an exempt partnership.

(ii) *Pre-transaction taxable year.* A *pre-transaction taxable year* is a taxable year ending during the pre-transaction period, if a CFC exemption election was in effect for the taxable year.

(iii) *Section 987 QBUs.* Annual unrecognized section 987 gain or loss must be computed with respect to each section 987 QBU (including each exempt partnership QBU) owned by the transferor CFC in a pre-transaction taxable year. Thus, for example, if the transferor CFC owned a section 987 QBU during a pre-transaction taxable year, and the section 987 QBU was terminated or the CFC exemption election was revoked before the inbound nonrecognition transaction occurred, annual unrecognized section 987 gain or loss must nevertheless be computed with respect to the section 987 QBU for the taxable years preceding the termination or revocation.

(iv) *Annual unrecognized section 987 gain or loss with respect to an exempt partnership QBU.* In the case of an exempt partnership QBU, annual unrecognized section 987 gain or loss for a taxable year is equal to the amount of gain or loss that the owner would have recognized under section 987(3) if the QBU was formed on the first day of the taxable year (or, if later, the date on which the QBU was actually formed) and terminated on the last day of the taxable year (or, if earlier, the date on which the QBU was actually terminated). This amount must be determined without regard to the CFC exemption election (and without regard to the rules of §§ 1.987–7(d) and 1.987–11 through 1.987–13) using a reasonable method that is applied consistently with respect to all partnerships in which the transferor CFC is a partner.

(v) *Exempt partnerships*—(A) *In general.* If the transferor CFC is a partner in an exempt partnership in a pre-transaction taxable year, the transferor CFC's section 987 asset basis must be determined by taking into account the transferor CFC's share of the exempt partnership's annual unrecognized section 987 gain or loss (determined under paragraph (c)(2)(iv) of this section) with respect to each section 987 QBU owned by the exempt partnership for each pre-transaction taxable year in which the partnership was an exempt partnership. This amount is translated, if necessary, into the transferor CFC's functional currency at the spot rate on the date of the inbound nonrecognition transaction.

(B) *Transferor CFC's share of an exempt partnership's annual unrecognized section 987 gain or loss.* The transferor CFC's share of an exempt partnership's annual unrecognized section 987 gain or loss with respect to a section 987 QBU for a taxable year is equal to the amount of section 987 gain or loss that would be included in the transferor CFC's distributive share of profits or losses with respect to the section 987 QBU for the taxable year if the exempt partnership recognized the annual unrecognized section 987 gain or loss in the taxable year. The principles of section 706(d) apply in making this determination.

(3) *Excess asset basis methodology.* If a taxpayer uses the excess asset basis methodology described in this paragraph (c)(3), a transferor CFC's section 987 asset basis with respect to an inbound nonrecognition transaction is equal to the amount of excess asset basis determined under § 1.367(b)–3(g)(2)(i) with respect to the transferor CFC. This amount is translated (if necessary) into the transferor CFC's functional currency at the spot rate on the date of the inbound nonrecognition transaction. Notwithstanding § 1.367(b)–3(g)(2)(i), for purposes of this paragraph (c)(3), excess asset basis is determined without regard to the application of paragraph (d) of this section.

(d) *Recognition of section 987 gain equal to the amount of section 987 asset basis*—(1) *In general.* Immediately before an inbound nonrecognition transaction, the transferor CFC is required to recognize section 987 gain equal to the amount of its section 987 asset basis.

(2) *Source and character*—(i) *In general.* The source and character of section 987 gain recognized under paragraph (d)(1) of this section are determined under the rules of § 1.987–6, subject to the modifications described in paragraph (d)(2)(ii) of this section. *See* § 1.987–6(b)(1)(vi).

(ii) *Initial assignment is made by reference to all of the transferor CFC's assets.* Notwithstanding § 1.987–6(b)(2)(i)(A), for purposes of the initial assignment, section 987 gain recognized under paragraph (d)(1) of this section is assigned to the statutory and residual groupings in the same proportions as the proportions in which the tax book value of the assets of the transferor CFC (other than stock described in § 1.987–2(b)(2)(i)(A)) are assigned to the groupings under the asset method in §§ 1.861–9(g) and 1.861–9T(g) in the taxable year of the initial assignment.

(e) *De minimis rule*—(1) *In general.* The rules of paragraphs (c) and (d) of this section do not apply to an inbound nonrecognition transaction if the transferor CFC's inside asset basis is less than $25 million. If multiple inbound nonrecognition transactions occur as part of the same plan or arrangement, all transferor CFCs' assets are aggregated for this purpose.

(2) *Inside asset basis.* In general, for purposes of paragraph (e)(1) of this section, a transferor CFC's inside asset basis is determined under § 1.367(b)–3(g)(2)(iv). However, the basis of stock of a corporation owned by the transferor CFC that is described in § 1.987–2(b)(2)(i)(A) is taken into account only to the extent of the transferor CFC's aggregate adjusted basis in assets (other than stock described in § 1.987–2(b)(2)(i)(A)) or the amount of the transferor CFC's functional currency that was exchanged for stock of the CFC (for example, in a transaction to which section 351 applies) during the pre-transaction period.

(f) *Example: Computation of section 987 asset basis.* The following example illustrates the rules of this section. For purposes of this example, except as otherwise indicated, no section 987 elections are in effect. This example is not intended to illustrate the appropriate determination of any QBU's functional currency.

(1) *Facts*—(i) *In general.* U.S. Corp is a domestic corporation that uses the calendar year as its taxable year and has the U.S. dollar as its functional currency. U.S. Corp owns 100 percent of the stock of CFC 1 (a controlled foreign corporation within the meaning of section 957(a)), which also uses the calendar year as its taxable year and has the U.S. dollar as its functional currency. CFC 1 forms Business A, a section 987 QBU with the euro as its functional currency, at the beginning of Year 1. At the beginning of Year 1, U.S. Corp's adjusted basis in the stock of CFC 1 is zero, and no assets or liabilities of CFC 1 are attributable to Business A. A CFC exemption election is in effect with respect to CFC 1 beginning in Year 1.

(ii) *Exchange rates.* The spot rate on December 31, Year 1, is €1 = $1.15. The yearly average exchange rate for Year 1 is €1 = $1.10. The spot rate on June 30, Year 2 is €1 = $1.25.

(iii) *Year 1 income and activities.* In Year 1, Business A earns income of €100x, which is subpart F income. Business A purchases Property X, a nondepreciable asset, for €100x. Under § 1.987–3(c), Business A's income of €100x is translated into CFC 1's functional currency at the yearly average exchange rate of €1 = $1.10. Therefore, CFC 1 has $110x of subpart F income (€100x × ($1.10/€1)). Under section 961(a), U.S. Corp's adjusted basis in the stock of CFC 1 is increased by $110x.

(iv) *Liquidation of CFC 1.* On June 30, Year 2, CFC 1 distributes Property X to U.S. Corp in a liquidation to which section 332 applies. Immediately before the liquidation, CFC 1 and Business A have no liabilities and no assets other than Property X. CFC1 has inside asset basis of at least $25 million.

(2) *Analysis*—(i) *Termination of Business A QBU.* Under § 1.987–8(b)(4) and (c)(1)(ii), the Business A QBU terminates as a result of the liquidation of CFC 1. Therefore, under § 1.987–8(e), Business A is deemed to transfer Property X to CFC 1 immediately before the termination, on June 30, Year 2. As a result, immediately before the liquidation, CFC 1's basis in Property X is $125x (equal to Business A's basis of €100x, translated at the June 30, Year 2, spot rate of €1 = $1.25). *See* § 1.987–5(f)(2).

(ii) *Computation of section 987 asset basis*—(A) *In general.* CFC 1 was subject to a CFC exemption election during the pre-transaction period described in paragraph (b)(2) of this section. Thus, under paragraph (d) of this section, CFC 1 is required to recognize section 987 gain immediately before the liquidation in an amount equal to its section 987 asset basis. Under paragraph (c) of this section, CFC 1 may compute the amount of section 987 asset basis using either the lookback methodology or the excess asset basis methodology.

(B) *Lookback methodology*—(*1*) *In general.* Under the lookback methodology provided in paragraph (c)(2) of this section, CFC 1's section 987 asset basis is equal to the sum of its annual unrecognized section 987 gain or loss with respect to Business A determined under § 1.987–10(e)(3)(iii) for each pre-transaction taxable year. For each taxable year, CFC 1's annual unrecognized section 987 gain or loss with respect to Business A is calculated by applying only Steps 1 and 10 of the ten-step determination under § 1.987–4(d). CFC 1's pre-transaction taxable years are the full taxable year beginning January 1, Year 1, and the short taxable year beginning January 1, Year 2, and ending June 30, Year 2. As explained in paragraph (f)(2)(ii)(B)(*2*) of this section, CFC 1 has annual unrecognized section 987 gain of $5x in Year 1, and CFC 1 has annual unrecognized section 987 gain of $10x in Year 2. Thus, under the lookback methodology, CFC 1's section 987 asset basis equals $15x ($5x + $10x), and CFC 1 recognizes $15x of section 987 gain under paragraph (d)(1) of this section.

(*2*) *Annual unrecognized section 987 gain or loss*—(*i*) *Year 1.* For Year 1, CFC 1's annual unrecognized section 987 gain equals $5. The change in owner functional currency net value (Step 1) equals $115x (€100x × ($1.15/€1) − 0). Step 10 reduces this amount by the residual increase to net assets determined in Business A's functional currency (the €100x basis in Property X), translated into CFC 1's functional currency at the yearly average exchange rate (€1 = $1.10). Thus, the reduction in Step 10 equals $110x, and CFC 1 has annual unrecognized gain of $5x ($115x − $110x).

(*ii*) *Year 2.* For short Year 2, CFC 1's annual unrecognized section 987 gain equals $10x. This is equal to the amount determined in Step 1. The Step 1 amount is $10x, equal to the difference in Business A's €100x balance sheet translated into CFC 1's functional currency at the spot rate on the last day of Year 2 (€1 = $1.25) and the spot rate on the last day of Year 1 (€1 = $1.15). The Step 10 amount for Year 2 is zero because there is no residual increase or decrease to Business A's net assets as determined in Business A's functional currency; throughout Year 2, Business A had net assets of €100x.

(C) *Excess asset basis methodology.* Under the excess asset basis methodology provided in paragraph (c)(3) of this section, CFC 1's section 987 asset basis is equal to the amount of excess asset basis determined under § 1.367(b)–3(g)(2)(i). Under § 1.367(b)–3(g)(2)(i) (applied without regard to paragraph (d) of this section), the excess asset basis is equal to CFC 1's inside asset basis (determined in the hands of U.S. Corp immediately after the liquidation of CFC 1) minus the sum of CFC 1's earnings and profits (excluding previously taxed earnings and profits); U.S. Corp's aggregate basis in the stock of CFC 1 immediately before the liquidation of CFC 1; and the aggregate amount of any liabilities assumed by U.S. Corp as a result of the liquidation of CFC 1. CFC 1's inside asset basis equals $125x, as explained in paragraph (f)(2)(iii) of this section. CFC 1 has no earnings and profits (other than previously taxed earnings and profits), and no liabilities. U.S. Corp's aggregate basis in the stock of CFC 1 is $110x. Accordingly, the excess asset basis with respect to CFC 1 is $15x ($125x minus $110x). Thus, under the excess asset basis methodology, CFC 1's section 987 asset basis equals $15x, and CFC 1 recognizes $15x of section 987 gain under paragraph (d)(1) of this section.

(iii) *Liquidation of CFC 1.* For purposes of section 334(b), section 987 gain recognized under paragraph (d) of this section is not treated as gain recognized with respect to property distributed by CFC 1 in the liquidation, because the gain is recognized immediately before the liquidation. Therefore, under section 334(b), U.S. Corp receives Property X with a basis of $125x.

■ Par. 9. Newly redesignated § 1.987–17 is amended by adding paragraphs (e) and (f) to read as follows:

§ 1.987–17 Applicability date.

* * * * *

(e) *Applicability date of 120-month amortization rule.* Section 1.987–10(e)(5)(ii) applies to taxable years beginning after December 31, 2024, and ending on or after November 25, 2025. *See* § 1.987–15, as contained in 26 CFR in part 1 in effect on April 1, 2025, for a prior applicability date for § 1.987–10(e)(5)(ii).

(f) *Applicability date of rules relating to the CFC exemption election.* Sections 1.987–1(g)(2)(iv) and (g)(3)(ii)(D), 1.987–6(b)(1)(v) and (vi), 1.987–7(b)(2), (c)(2)(iv), and (d)(2)(iv), and 1.987–15 apply to taxable years ending on or after [date of filing of final regulations with the **Federal Register**]. Section 1.987–16 applies to transactions completed within taxable years of a domestic acquiring corporation ending on or after [date of filing of final regulations with the **Federal Register**]. *See* § 1.987–15, as contained in 26 CFR in part 1 in effect on April 1, 2025, for a prior applicability date for § 1.987–7(b).

Frank J. Bisignano,

Chief Executive Officer.

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DEPARTMENT OF THE TREASURY

Alcohol and Tobacco Tax and Trade Bureau

27 CFR Part 9

[Docket No. TTB–2026–0005; Notice No. 243]

RIN 1513–AD09

Proposed Establishment of the Llano Uplift and Hickory Sands District Viticultural Areas

AGENCY: Alcohol and Tobacco Tax and Trade Bureau, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Alcohol and Tobacco Tax and Trade Bureau (TTB) proposes to establish the 2,096-square mile ''Llano Uplift'' American viticultural area (AVA) in portions of Blanco, Burnet, Gillespie, Llano, Mason, McCulloch, and San Saba Counties in Texas. The proposed AVA entirely encompasses the established Bell Mountain AVA. TTB is also proposing to establish the 193-square mile ''Hickory Sands District'' AVA in portions of Llano, Mason, McCulloch, and San Saba Counties in Texas. TTB is proposing these two AVAs simultaneously because, if established, the proposed Hickory Sands District AVA would be located entirely within the proposed Llano Uplift AVA. Additionally, both proposed AVAs are located entirely within the boundaries of the existing Texas Hill Country AVA. TTB designates viticultural areas to allow vintners to better describe the origin of their wines and to allow consumers to better identify wines they may purchase. TTB invites comments on these proposals.

DATES: TTB must receive your comments on or before October 13, 2026.

ADDRESSES: You may electronically submit comments to TTB on this proposal, and view copies of this document, its supporting materials, and any comments TTB receives on it within Docket No. TTB–2026–0005 as posted on *Regulations.gov* (*https://www.regulations.gov*), the Federal e-rulemaking portal. Alternatively, you may submit comments via postal mail to the Director, Regulations and Ruling Division, Alcohol and Tobacco Tax and Trade Bureau, 1310 G Street NW, Box 12, Washington, DC 20005. Please see the ''Public Participation'' section of this document for further information on the comments requested on this proposal and on the submission, confidentiality, and public disclosure of comments.

FOR FURTHER INFORMATION CONTACT: Karen A. Thornton, Regulations and Rulings Division, Alcohol and Tobacco Tax and Trade Bureau, 1310 G Street, NW, Box 12, Washington, DC 20005; phone 202–453–1039, ext. 175.

SUPPLEMENTARY INFORMATION: In accordance with 5 U.S.C. 553(b)(4), a summary of this rule may be found at *https://www.regulations.gov/docket/TTB-2026-0005.*

Background on Viticultural Areas

TTB Authority

Section 105(e) of the Federal Alcohol Administration Act (FAA Act), 27 U.S.C. 205(e), authorizes the Secretary of the Treasury to prescribe regulations for the labeling of wine, distilled spirits, and malt beverages. The FAA Act provides that these regulations should, among other things, prohibit consumer deception and the use of misleading statements on labels and ensure that labels provide the consumer with adequate information as to the identity and quality of the product. The Alcohol and Tobacco Tax and Trade Bureau (TTB) administers the FAA Act provisions pursuant to section 1111(d) of the Homeland Security Act of 2002, as codified at 6 U.S.C. 531(d). The Secretary has delegated the functions and duties in the administration and enforcement of these provisions to the TTB Administrator through Treasury Order 120–01.

Part 4 of the TTB regulations (27 CFR part 4) authorizes TTB to establish definitive viticultural areas and regulate the use of their names as appellations of origin on wine labels and in wine advertisements. Part 9 of the TTB regulations (27 CFR part 9) sets forth standards for the preparation and submission of petitions for the establishment or modification of American viticultural areas (AVAs) and lists the approved AVAs.

Definition

Section 4.25(e)(1)(i) of the TTB regulations (27 CFR 4.25(e)(1)(i)) defines a viticultural area for American wine as a delimited grape-growing region having distinguishing features as described in part 9 of the regulations and, once approved, a name and a delineated boundary codified in part 9 of the regulations. These designations allow vintners and consumers to attribute a given quality, reputation, or other characteristic of a wine made from grapes grown in an area to the wine's geographic origin. The establishment of AVAs allows vintners to describe more