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Global Tax Alert

US IRS further delays certain Section 987 foreign currency regulations

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On 6 December 2019, the United States (US) Department of the Treasury (Treasury) and Internal Revenue Service (IRS) announced (Notice 2019-65) that they intend to amend the final Internal Revenue Code (IRC)[1] Section 987 regulations issued in 2016 (T.D. 9794, the 2016 Final Regulations),[2] as well as certain related final regulations issued in 2019 (T.D. 9857, the 2019 Final Regulations),[3] to further delay their applicability date by one additional year.[4]

Background

2016 Final and Temporary Regulations

On 7 December 2016, Treasury and the IRS released final (T.D. 9794), temporary (T.D. 9795), and proposed regulations (REG-128276-12) under Section 987. The 2016 Final Regulations provide guidance to corporate and individual taxpayers on determining taxable income for qualified business units (QBUs) whose functional currency differs from their owner (each an "IRC Section 987 QBU"). They also provide guidance on the timing, amount, character and source of any Section 987 gain or loss arising from those QBUs.

The temporary regulations provided rules on combining and separating QBUs (Treas. Reg. Sections 1.987-2T and 1.987-4T), rules providing a liquidation value percentage methodology for allocating assets and liabilities of Section 987 aggregate partnerships (Treas. Reg. Section 1.987-7T), and rules requiring the deferral of foreign currency gain or loss under Section 987 for certain transactions defined as deferral events or outbound loss events (Treas. Reg. Section 1.987-12T).

Regulatory review of the Section 987 Regulations

Notice 2017-38 identified Section 987 as a significant tax regulation requiring additional review under Executive Order 13789. In the Second Report to the President on Identifying and Reducing Tax Regulatory Burdens, published on 16 October 2017 (the Second Report to the President),[5] Treasury indicated that it was considering changes to the 2016 Final Regulations that would allow taxpayers to apply alternative rules for transitioning to the 2016 Final Regulations and for determining Section 987 gain or loss.

Previous deferrals

In Notice 2017-57, issued 16 October 2017, Treasury and the IRS announced that future guidance would defer the applicability dates of certain provisions of the 2016 Final Regulations and temporary regulations by one year. On 25 June 2018, in Notice 2018-57, Treasury and the IRS announced amendments to further delay the applicability of the 2016 Final Regulations and certain provisions of the temporary regulations by one additional year. Consequently, the 2016 Final Regulations and certain provisions of the temporary regulations would have applied (absent the latest guidance) to tax years beginning on or after *three years* after the first date of the first tax year following 7 December 2016 (i.e., 1 January 2020, for in-scope, calendar-year taxpayers).[6]

2019 Final Regulations

In final regulations (T.D. 9857) effective 13 May 2019, Treasury and the IRS finalized certain provisions of the 2016 temporary regulations addressing recognition and deferral of Section 987 gain or loss. Specifically, they finalized, with certain clarifications, Treas. Reg. Sections 1.987-2T and -4T (on combinations and separations of QBUs subject to Section 987) and Treas. Reg. Section 1.987-12T (addressing recognition and deferral of Section 987 gain and loss upon certain QBU terminations and certain other transactions involving partnerships). In addition, Treasury and the IRS withdrew Treas. Reg. Section 1.987-7T (regarding the allocation of assets and liabilities of certain partnerships for purposes of Section 987).[7]

Notice 2019-65

Notice 2019-65 announces intended amendments to further delay the application of the 2016 Final Regulations and certain provisions of the 2019 Final Regulations by one additional year. Consequently, these regulations will now apply to tax years beginning on or after 7 December 2020 (i.e., 1 January 2021, for in-scope, calendar-year taxpayers). Notably, the applicability date of Treas. Reg. Section 1.987-12 is not delayed, so the deferral event and outbound loss event rules of Treas. Reg. Section 1.987-12 generally apply to events occurring on or after 6 January 2017.

The Treasury and the IRS noted that the related 2016 temporary regulations expired on 6 December 2019, and that the amended applicability date will apply for purposes of the related proposed regulations.

The Treasury and the IRS also reiterated their intent to consider changes to the final regulations to permit taxpayers to elect to apply simplified alternative rules for transitioning to the final regulations and alternative rules for determining Section 987 gain or loss as discussed in the Second Report to the President.[8]

Taxpayers may rely on the provisions of Notice 2019-65 before amendments to the final regulations are issued.

Implications

As noted in our previous EY Global Tax Alert, *US: Additional delay of Section 987 foreign currency regulations has immediate significance for taxpayers, including CFCs*, dated 19 June 2018, the delayed applicability date provides taxpayers additional time to create and implement the complex systems and processes necessary to transition to the Final Section 987 Regulations. Additionally, as reiterated in Notice 2019-65, Treasury and the IRS are considering alternative rules that could simplify compliance with Section 987.

In the meantime, taxpayers must compute Section 987 gain or loss under a reasonable method and must also apply the deferral or outbound loss event rules of Treas. Reg. Section 1.987-12, which currently apply. Additionally, taxpayers need to consider the interaction of Section 987, US tax reform provisions and recently issued final regulations. Specifically, US owners of Section 987 QBUs will have to consider how their current Section 987 calculations:

- Affect taxable income for purposes of the BEAT provisions of Section 59A
- Affect adjusted taxable income for purposes of the interest expense limitation provisions of Section 163(j)
- Interact with the foreign branch income basket rules under Section 904(d)

CFC owners of Section 987 QBUs will also need to consider the effect of their Section 987 determinations on their Section 951A GILTI calculations and potential effects on subpart F income.

Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. The 2016 Final Regulations prescribe an entirely different approach to computing taxable income or loss and Section 987 gain or loss of an Section 987 QBU than has been used by most taxpayers for the past 30 years and impose substantial recordkeeping and compliance requirements.
3. The 2019 Final Regulations finalized certain temporary regulations dealing with combinations and separations of Section 987 QBUs and the recognition and deferral of foreign currency gain or loss under Section 987 in connection with certain QBU terminations and certain other transactions.
4. Specifically, Notice 2019-65 announces that the Treasury and the IRS intend to amend Treas. Reg. Sections 1.861-9T, 1.985-5, 1.987-11, 1.988-1, 1.988-4 and 1.989(a)-1 of the 2016 Final Regulations and Treas. Reg. Sections 1.987-2 and 1.987-4 of the 2019 Final Regulations to apply to tax years beginning on or after the first day of the first tax year following 7 December 2020.
5. 82 Fed. Reg. 48013.
6. See EY Global Tax Alert, *US: Additional delay of Section 987 foreign currency regulations has immediate significance for taxpayers, including CFCs*, dated 19 June 2018.
7. See EY Global Tax Alert, *US IRS finalizes certain temporary foreign currency regulations addressing recognition and deferral of Section 987 gain or loss*, dated 16 May 2019.
8. See 82 Fed. Reg. 48013.

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