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Global Tax Alert

US IRS delays certain Section 987 foreign currency regulations for additional year

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On 17 September 2020, the United States (US) Department of the Treasury (Treasury) and Internal Revenue Service (IRS) announced (Notice 2020-73) their intent to amend the final Internal Revenue Code[1] Section 987 regulations issued in 2016 (T.D. 9794, the 2016 Final Regulations), as well as certain related final regulations issued in 2019 (T.D. 9857, the 2019 Final Regulations), to further delay their applicability date by one additional year (e.g., to 2022 for calendar-year taxpayers).[2]

Background

2016 Final, temporary and proposed regulations

On 8 December 2016, Treasury and the IRS published final (T.D. 9794), temporary (T.D. 9795) and proposed regulations (REG-128276-12) under Section 987. The 2016 Final Regulations provide guidance to corporations and individuals on determining taxable income or loss for a qualified business unit (QBU) whose functional currency differs from its owner (a Section 987 QBU). They also provide guidance on the timing, amount, character and source of any Section 987 gain or loss arising from such a QBU. The temporary regulations, some of which were finalized in T.D. 9857, provided rules for deferring Section 987 gain or loss in connection with certain Section 987 QBU terminations and transactions involving partnerships, as well as other related elections and special rules. The proposed regulations cross-referenced the temporary regulations.

The 2016 Final Regulations' prescribed approach for computing taxable income or loss and Section 987 gain or loss of a Section 987 QBU differs entirely from that used by most taxpayers for more than 30 years. The regulations also impose substantial recordkeeping and compliance requirements. The prior deferral notices, discussed later, indicated that Treasury and the IRS were considering changes to the 2016 Final Regulations to permit taxpayers to elect to apply alternative rules for transitioning to the 2016 Final Regulations and alternative rules for determining Section 987 gain or loss.

2019 Final Regulations

In T.D. 9857, effective 13 May 2019, Treasury and the IRS finalized certain provisions of the 2016 temporary regulations. Specifically, Treas. Reg. Sections 1.987-2T and -4T (on combinations and separations of Section 987 QBUs) and Treas. Reg. Section 1.987-12T (addressing recognition and deferral of Section 987 gain and loss upon certain Section 987 QBU terminations and certain other transactions involving partnerships) were finalized with certain clarifications. 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). See EY Global Tax Alert, *US IRS finalizes certain temporary foreign currency regulations addressing recognition and deferral of IRC Section 987 gain or loss*, dated 16 May 2019.

Previous deferrals of applicability date

The 2016 Final Regulations originally applied to tax years beginning on or after one year after the first day of the first tax year beginning after 7 December 2016, (e.g., to 2018 for calendar-year taxpayers). The applicability date of the 2016 Final Regulations, however, has been deferred several times.

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 (e.g., to 2019 for calendar-year taxpayers). On 25 June 2018, in Notice 2018-57, Treasury and the IRS announced amendments to further delay the applicability date of the 2016 Final Regulations and certain provisions of the temporary regulations by one additional year (e.g., to 2020 for calendar-year taxpayers). Most recently, on 6 December 2019, in Notice 2019-65, Treasury and the IRS announced another delay to the applicability date of the 2016 Final Regulations, as well as the related 2019 Final Regulations, for one additional year (e.g., to 2021 for calendar-year taxpayers). See EY Global Tax Alert, *US IRS further delays certain IRC Section 987 foreign currency regulations*, dated 12 December 2019.

Notice 2020-73

Notice 2020-73 announces intended amendments to further delay the applicability date of the 2016 Final Regulations and certain related provisions of the 2019 Final Regulations by one additional year. Consequently, these regulations will now apply to tax years beginning after 7 December 2021 (e.g., to 2022 for calendar-year taxpayers). Consistent with Notice 2019-65, the applicability date of Treas. Reg. Section 1.987-12 was not changed, 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.

As noted by Treasury and the IRS, the related 2016 temporary regulations expired on 6 December 2019, and the proposed regulations that were not finalized in 2019 remain outstanding.

Taxpayers may rely on the provisions of Notice 2020-73 before amendments to the final regulations are issued. Taxpayers may also choose to apply the 2016 Final Regulations, the related temporary regulations (until they were revoked or expired, as applicable), and the related 2019 Final Regulations (beginning on 13 May 2019) to tax years beginning after 7 December 2016, and before 8 December 2021, provided the taxpayer and its related parties consistently apply those regulations to such tax years.

Although the temporary regulations have expired, the Notice indicates that taxpayers can rely on certain provisions of the proposed regulations, provided the taxpayer and its related parties consistently follow the proposed regulations in their entirety and apply the 2016 Final Regulations and the related 2019 Final Regulations for the same tax year. A taxpayer may rely on the annual deemed termination election provisions of the proposed regulations, provided that the taxpayer and its related parties consistently follow those proposed regulations in their entirety. Additionally, taxpayers may rely on Sections 1.987-7 (Section 987 aggregate partnerships) and 1.988-2(b)(16) (deferral of loss on certain related-party debt instruments) of the proposed regulations, provided that the taxpayer and its related parties consistently follow each Section of those proposed regulations.

Implications

Although the deferral was expected, the new guidance should be a welcome relief for taxpayers, as the delayed applicability date provides additional time for taxpayers to create and implement the complex systems and processes necessary to transition to the Section 987 Final Regulations. Unfortunately, unlike prior deferral notices, Notice 2020-73 does not indicate that the IRS is considering changes to simplify the regulations.

Until the final regulations are effective, taxpayers must compute Section 987 gain or loss under a reasonable method and must also use the deferral or outbound loss event rules of Treas. Reg. Section 1.987-12, which currently apply. Additionally, taxpayers need to consider that Section 987 gain or loss affects taxable income, which in turn affects other provisions, such as the limitation on interest expense under Section 163(j), the base erosion and anti-abuse tax (BEAT) under Section 59A, calculations of global intangible low-taxed income under Section 951A, the subpart F income rules under Section 951, and the foreign-branch income-basket rules under Section 904(d).

Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. Specifically, Notice 2020-73 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 after 7 December 2021.

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