NEW YORK STATE BAR ASSOCIATION
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Report No. 1526
April 26, 2026

The Honorable Scott Bessent
Secretary of the Department of the Treasury, and Acting Commissioner of the Internal Revenue Service
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Kenneth J. Kies
Assistant Secretary (Tax Policy) of the Department of the Treasury, and Acting Chief Counsel of the Internal Revenue Service
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: NYSBA Tax Section Report No. 1526 - Report on Notice 2026-17

Dear Secretary Bessent and Assistant Secretary Kies:

Please see attached Report No. 1526 of the Tax Section of the New York State Bar Association (the "**Report**") commenting on select issues under Notice 2026-17 (the "**Notice**"). The Notice was issued by the Department of the Treasury ("**Treasury**") and the Internal Revenue Service (the "**IRS**") on February 25, 2026. The Notice announces the intention of Treasury and the IRS to issue proposed regulations modifying and clarifying certain rules under section 987 of the Internal Revenue Code, including by providing an election under which controlled foreign corporations generally would not be required to compute or recognize foreign currency gain or loss under section 987(3) (the "**CFC Election**"). This Report focuses its recommendations on the CFC Election.

We commend Treasury and the IRS for undertaking to simplify and refine the application of section 987 to controlled foreign corporations by proposing the CFC Election. Properly structured, the proposed election has the potential to reduce complexity and improve administrability for certain taxpayers with the inclusion of appropriate safeguards to prevent the

creation of undue opportunities for abuse**.** The Report provides suggestions for improving the CFC Election as a substantive and procedural matter. The Report also identifies certain additional issues regarding the operation of the CFC Election with respect to which guidance should be provided in order for taxpayers and the government to better implement and administer the election.

We appreciate the opportunity to comment on Notice 2026-17 and thank Treasury and the IRS for considering the views of the Tax Section. If you have any questions or would like to discuss any aspect of the Report, please do not hesitate to contact us. We would be pleased to assist in any way.

Respectfully submitted,

Lawrence M. Garrett
Chair

Enclosure

cc:

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Report No. 1526

NEW YORK STATE BAR ASSOCIATION TAX SECTION

REPORT ON NOTICE 2026-17:
MODIFICATION TO CERTAIN RULES UNDER SECTION 987

April 26, 2026

TABLE OF CONTENTS

REPORT ON NOTICE 2026-17: MODIFICATION TO CERTAIN RULES UNDER SECTION 987

I. Introduction

This report (the "**Report**")[1] provides select comments of the Tax Section of the New York State Bar Association (the "**Tax Section**") on Notice 2026-17 (the "**2026 Notice**") issued by the Department of the Treasury ("**Treasury**") and the Internal Revenue Service (the "**IRS**") under section 987(3)[2] on February 25, 2026. We have previously provided comments on the regulations proposed in 2006, submitted on January 3, 2008[3]; on Notice 2017-57, regarding changes to the regulations finalized in 2016, submitted on January 22, 2018[4]; and on select topics in the proposed regulations under Section 987, submitted February 12, 2024[5].

The 2026 Notice announces the intent of Treasury and the IRS to issue proposed regulations on certain aspects of computation and application of section 987. As relevant to this Report, Treasury and the IRS intend to issue future guidance that would provide an election under which controlled foreign corporations ("**CFCs**") generally would not be required to compute or recognize foreign currency gain or loss under section 987(3) (the "**CFC Election**").

[1] The principal authors of this Report are Rebecca Lee and Lee Holt. Helpful comments were received from Kimberly Blanchard, Lucy Farr, Lawrence Garrett, Michael Schler, Vikram Sharma, and Wade Sutton. This Report reflects solely the views of the Tax Section and not those of its individual members or any other party.

[2] Unless otherwise indicated, all references in this Report to "**Section**," "**Sections**" and "**§**" are to the Internal Revenue Code of 1986, as amended (the "**Code**"), and all references to "**Treas. Reg. §**" or "**Prop. Treas. Reg. §**" are to regulations or proposed regulations issued thereunder.

[3] New York State Bar Ass'n Tax Section, *Report on Proposed Regulations Under Section 987* (Report No. 1140, Jan. 3, 2008).

[4] New York State Bar Ass'n Tax Section, *Report on Notice 2017-57: Alternative Rules for Determining Section 987 Gain or Loss* (Report No. 1386, Jan. 2018).

[5] New York State Bar Ass'n Tax Section, *Report on Proposed Regulations under Section 987* (Report No. 1488, Feb. 2024).

We commend Treasury and the IRS for proposing the CFC Election because, properly structured, it will reduce complexity and improve administrability for certain taxpayers with the inclusion of appropriate safeguards to prevent the creation of undue opportunities for abuse**.** The proposed election substantially reduces the annual compliance burden for taxpayers operating their non-U.S. activities through QBUs owned by one or more CFCs, particularly in circumstances in which the assets of the QBUs are not expected to be repatriated to the United States.[6] We have several suggestions, discussed in more detail below, for improving the CFC Election as a substantive and procedural matter.

This Report is organized into four parts including this Introduction. Part II provides a summary of our recommendations. Part III provides an overview of those portions of the statutory and regulatory framework relevant to this Report. Part IV provides a discussion of our recommendations. The Report addresses specific proposals in the 2026 Notice with respect to which we have recommendations but does not address all aspects of the 2026 Notice.

II. Summary of Recommendations

The following is a summary of our recommendations in this Report:

1. As proposed, the CFC Election must be made on an originally filed return (including extensions) for any taxable year, including the 2025 tax year. We recommend, for the 2025 taxable year only, permitting taxpayers to make the CFC Election on an amended return filed before the original return due date (with extensions) for the 2026 taxable year. Further, we suggest clarifying certain consequences of the election, including the effect of revocation of the election and the implications of making the election for subsequent business combinations and dispositions.

[6] We note that Treasury and the IRS had previously proposed regulations to simplify the application of section 987 to certain recurring disregarded transactions between a QBU and its owner or amongst QBUs. Even assuming the finalization of these proposed regulations, taxpayers with multiple QBUs still must calculate section 987 gain or loss related to remittances not covered by the proposed regulations and retain books and records to support future calculations.

2. In the case of an inbound asset reorganization or liquidation of a CFC for which the CFC Election has been made (an "**Inbound Transaction**"), the basis of assets received from the CFC should be reduced to account for the section 987 gain (but not loss) that would have been taken into account by the CFC had it not made the CFC Election. In addition, we suggest considering whether additional rules are needed to prevent abuse and/or unintended consequences, including, for example, rules to prevent the basis-reduction mechanics from changing the source or character of income attributable to foreign currency fluctuations.
3. Taxpayers should have the option to calculate the basis adjustment in the case of an Inbound Transaction based on information the taxpayer would have without having to calculate section 987 gain or loss.
4. Any adjustment to the basis of assets in an Inbound Transaction should only be required where the adjustment exceeds a de minimis threshold, and taxpayers should have the option to substantiate that the adjustment does not exceed such de minimis threshold based on information that does not require the calculation of section 987 gain or loss.
5. The Inbound Transaction basis adjustment should be taken into account before the application of other provisions applicable to inbound reorganizations and liquidations, such as section 362(e)(1) and section 367(b).

III. Overview of Relevant Statutory Provisions, the Regulations Issued Thereunder and Notice 2026-17

A. General Rules

As part of the Tax Reform Act of 1986 (the "**TRA**"),[7] Congress added subpart J to the Code, which adopted the concept of functional currency for purposes of determining foreign currency gains or losses for U.S. federal income tax purposes.[8] Except when required to use the U.S. dollar as its functional currency,[9] the functional currency of a qualified business unit ("**QBU**")[10] is generally the currency of the economic environment in which a significant part of the activities are conducted.[11] Subpart J provides three mechanisms for taking into account the activities in non-functional currencies: section 986(c) (translational gain or loss from the activities of CFCs and passive foreign investment companies), section 987 (translational gain or loss from the activities of QBUs) and section 988 (transactional gain or loss from certain financial transactions denominated in a nonfunctional currency).

Section 986 provides the rules for the translation of foreign taxes, earnings and profits ("**E&P**"), and distributions from the taxpayer's functional currency to the U.S. dollar. Section 986(b) provides that E&P is determined based on the corporation's functional currency, and, in the case of any U.S. person, the E&P determined in the corporation's functional currency will be translated into U.S. dollars using the appropriate exchange rate when distributed, deemed distributed, or otherwise taken into account for U.S. federal income tax purposes. Section 986(c)

[7] Pub. L. No. 99-514, 100 Stat. 2085.

[8] All determinations under the Code are made in the taxpayer's functional currency unless otherwise provided in regulations. Section 985(a).

[9] Section 985(b)(1)(A); Treas. Reg. § 1.985-1(b).

[10] The term QBU means any separate and clearly identified unit of a trade or business of a taxpayer which maintains separate books and records. Section 989(a). Corporations, individuals, trusts and estates are "per se" QBUs. Treas. Reg. § 1.989(a)-1(b)(1). Treasury and the IRS continue to study the treatment of partnerships as QBUs, and the consequences for such determination for the application of section 987. *See* Preamble to the 2024 Final Regulations, T.D. 10016, 89 Fed. Reg. 100151 (December 11, 2024) ("**2024 Final Regulations**"). Activities conducted by a QBU could rise to the level of being a separate QBU if the activities constitute a trade or business and a separate set of books and records is maintained with respect to the activities.

[11] Section 985(b)(1)(B); Treas. Reg. § 1.985-1(b).

provides that foreign currency gain or loss with respect to distributions of previously taxed earnings and profits ("**PTEP**," as described in section 959 or 1293(c)) attributable to movements in exchange rates between the times of a deemed distribution and an actual distribution is recognized and treated as ordinary income or loss from the same source as the associated income inclusion.

Section 988 applies to certain transactions (referred to as "**section 988 transactions**") determined by reference to a nonfunctional currency on a transaction-by-transaction basis. Section 988 transactions include investments in nonfunctional currency, holding or issuing debt instruments denominated in a nonfunctional currency, and entering into certain derivatives with respect to nonfunctional currency and/or nonfunctional currency-denominated debt such as futures, forwards, options, and notional principal contracts.[12]

As discussed in greater detail below, Section 987 applies to business activities of a QBU conducted in a currency environment different than the taxpayer's own functional currency. Specifically, section 987 generally applies when a taxpayer (referred to as the "owner") has a QBU that operates in a functional currency that is different from that of the owner.

B. Section 987

Section 987 applies to any "taxpayer" having one or more QBUs with a functional currency other than the U.S. dollar. Taxable income or loss is computed separately for each QBU in its functional currency and such amount is translated at the appropriate exchange rate.[13] Under regulations to be issued by the Secretary, Section 987(3) makes proper adjustments for transfers of property between QBUs of the taxpayer having different functional currencies, including treating such remittances as made on a pro rata basis out of post-1986 E&P and treating gain or loss determined under section 987 as ordinary income or loss, respectively, and sourcing such

[12] Section 988(c)(1).

[13] Section 987(1) and (2). These rules are similar to Section 986(b).

gain or loss by reference to the source of the income giving rise to post-1986 accumulated earnings.

The House committee report accompanying the TRA stated that a remittance should trigger "gains and losses inherent in functional currency or other property remitted to the home office" in a manner that would generally treat activities conducted in branch form similar to those conducted through a subsidiary.[14] Treasury and the IRS previously have issued a series of complex regulations packages providing guidance on the application of section 987, including the timing, amount, and source of such gain or loss,[15] culminating in the finalization of most of the regulations proposed under section 987 in the 2024 Final Regulations.

C. Solicitation for Comments on QBUs Owned by CFCs

In general, and subject to specific statutory and regulatory exceptions, the gross income and taxable income of a CFC for any taxable year is determined by treating such foreign corporation as a domestic corporation taxable under section 11 and by applying the principles of section 61 and 63 (and the regulations thereunder), as applicable.[16] Various regulations packages issued under section 987 from 1991 until 2024 applied section 987(3) to CFCs.[17]

Concurrent with the publication of the 2024 Final Regulations, Treasury and the IRS issued a notice of proposed rulemaking which, in part, announced that Treasury and the IRS are studying whether there are instances in which it could simplify the application of section 987(3) to CFCs and partnerships with only foreign partners, including not applying section 987(3) to

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[14] H.R. Rep. No. 99-426, at 469-70 (1985). *See also* S. Rep. No. 99-313, at 455 (1986).

[15] Notice of Proposed Rulemaking, Calculation of Currency Gain or loss on Transfers from Qualified Business Unit Branches Using the Profit and Loss Method of Accounting, 56 Fed. Reg. 48457 (Sept. 25, 1991); Withdrawal of Notice of Proposed Rulemaking, Notice of Proposed Rulemaking and Notice of Public Hearing, Income and Currency Gain or Loss With Respect to a Section 987 QBU, 71 Fed. Reg. 52876 (Sept. 7, 2006); Final Regulations, Income and Currency Gain or Loss With Respect to a Section 987 QBU, 81 Fed. Reg. 88806 (Dec. 8, 2016); and Income and Currency Gain or Loss With Respect to a Qualified Business Unit, 88 Fed. Reg. 218 (Nov. 14, 2023) ("**2023 Proposed Regulations**").

[16] Treas. Reg. § 1.952-2(a) and (b).

[17] *See, e.g.,* 2023 Proposed Regulations at 88 Fed. Reg. 78143-4 (application of source and character rules to CFCs).

such entities.[18] In its solicitation of comments, the preamble noted a concern that, in the absence of the application of Section 987(3) to CFCs, economic currency gain could give rise to an increase in a CFC's aggregate inside basis (in U.S. dollar terms) without a corresponding increase in E&P for the CFC.[19] Treasury and the IRS noted their view that this difference, resulting in "excess asset basis" within the meaning of Treas. Reg. § 1.367(b)-3(g), could be imported into the U.S. and escape U.S. taxation permanently in the case of an inbound asset reorganization or liquidation described in Treas. Reg. § 1.367(b)-3.

D. 2026 Notice (Notice 2026-17)

1. Overview

The 2026 Notice announces the intention of the Treasury and the IRS to issue proposed regulations that would: (i) simplify the operation of the regulations issued under section 987, (ii) reduce compliance burdens, and (iii) refine the scope of certain rules to limit their effect on ordinary course of business transactions. Sections 3, 4 and 5 of the 2026 Notice describe the key areas of proposed guidance. While we summarize all three operative sections of the 2026 Notice below, this Report focuses its comments on Section 5.

2. Section 3 – Equity and Basis Pool Method

The 2026 Notice provides that forthcoming proposed regulations would allow taxpayers to make an election to determine taxable income or loss and foreign currency gain or loss with respect to a QBU using a method that is substantially similar to the method provided in regulations proposed in 1991 (i.e., an equity and basis pool method). The equity and basis pool method may be used only in a taxable year for which a current rate election is in effect. If an election to use the equity and basis pool method is in effect, taxpayers would determine section 987 taxable

[18] Notice of Proposed Rulemaking, Accounting for Disregarded Transactions Between a Qualified Business Unit and its Owner, 89 Fed. Reg. 99782 (Dec. 11, 2024) ("**2024 Proposed Regulations**").

[19] 2024 Proposed Regulations, 89 Fed. Reg. 99782 at 99786.

income or loss, net unrecognized section 987 gain or loss, and recognized section 987 gain or loss for a section 987 QBU as follows:

- *Section 987 taxable income or loss*. In general, taxpayers would determine section 987 taxable income or loss by computing each item of income, gain, deduction, or loss attributable to the section 987 QBU in its functional currency and then translating the net taxable income or loss into the owner's functional currency at the yearly average exchange rate.

- *Net unrecognized section 987 gain or loss.* In general, net unrecognized section 987 gain or loss would equal the equity pool (as determined in the section 987 QBU's functional currency) on the last day of the tax year translated into the owner's functional currency at the spot rate on the last day of the tax year (or termination date, if applicable) minus the basis pool (as determined in the owner's functional currency) on the last day of the tax year (or termination date, if applicable). Additional adjustments may be required for section 987 hedging transactions.

- *Recognized section 987 gain or loss.* Subject to the rules of Treas. Reg. §§ 1.987-11 through 1.987-13, the section 987 gain or loss recognized for a tax year equals the owner's net unrecognized section 987 gain or loss multiplied by the "remittance proportion." The remittance proportion generally equals the amount of the remittance divided by the sum of (i) the equity pool on the last day of the tax year, (ii) the aggregate amount of the section 987 QBU's liabilities on the last day of the tax year (expressed as a positive number), and (iii) the amount of the remittance, each determined in the section 987 QBU's functional currency. If a taxpayer makes an annual recognition election, the remittance proportion is one because this election requires the taxpayer to include all of its unrealized section 987 gain or loss each year regardless of the amount of any remittances from the QBU.

Importantly, all other rules of the 2024 Final Regulations (and the 2024 Proposed Regulations to the extent relied upon) generally apply while an equity and basis pool method election is in effect.

3. Section 4 – Clarification of 2024 Final Regulations

The rules described in Section 4 of the 2026 Notice would (i) narrow the scope of the loss suspension rules;[20] (ii) simplify the loss-to-the-extent-of-gain rule under which suspended section 987 loss is recognized; (iii) clarify the definition of a successor for purposes of the deferral rules; and (iv) expand the definition of a section 987 hedging transaction.

The 2026 Notice narrows the scope of the loss suspension rules to apply only in a tax year in which either (i) the remittance proportion exceeds 5%, or (ii) the total amount of net unrecognized or deferred section 987 losses that would otherwise become suspended exceed $5 million.

The 2026 Notice simplifies the loss-to-the-extent-of-gain rule. The 2026 Notice permits a domestic corporation to recognize suspended section 987 loss as a result of recognized section 987 gain that is assigned to any section 904 category. For section 987 QBUs owned by CFCs (or partnerships in which a partner is a CFC), the 2026 Notice limits the recognition groupings to tentative tested income, subpart F income, income described in section 952(b), and other income.

The 2026 Notice clarifies that a section 987 QBU is treated as a successor deferral QBU only if, among other things, a "significant portion" of the assets of the terminated section 987 QBU are reflected on the books and records of the potential successor deferral QBU immediately after the termination. For this purpose, the term "significant portion" has the meaning provided in Treas. Reg. § 1.987-13(l)(5) (i.e., a significant portion of the operating assets, determined based on all the facts and circumstances, provided that more than 30% of the operating assets will

[20] Under the default methodology of the 2024 Final regulations, certain items of a section 987 QBU (historic items) must be translated using historic exchange rates for purposes of computing section 987 taxable income or loss and net unrecognized section 987 gain or loss. See Treas. Reg. § 1.987-1(c)(3) and (e). However, the 2024 Final Regulations provide an election (current rate election or "**CRE**") under which all items of a section 987 QBU are translated at the current spot rate or yearly average exchange rate. See Treas. Reg. § 1.987-1(d)(2). In general, in a taxable year in which a current rate election is in effect, any section 987 loss that would otherwise be recognized as a result of a remittance is treated as suspended section 987 loss (CRE loss suspension rule). See Treas. Reg. § 1.987-11(c)(1). A similar rule applies to partnerships and S corporations under Treas. Reg. § 1.987-7(d)(1)(ii) (partnership loss suspension rule).

constitute a significant portion in all cases and less than 10% of the operating assets will not constitute a significant portion in all cases).

The definition of a section 987 hedging transaction would be expanded to cover certain hedges that do not meet the U.S. GAAP hedging requirement of Treas. Reg. § 1.987-14(b)(2)(iv).

4. Section 5 – Application of Section 987(3) to CFCs

The 2026 Notice states that Treasury and the IRS intend to issue future guidance establishing an election under which CFCs generally would not be required to compute or recognize section 987 gain or loss. However, the rules of section 987(1) and (2) would continue to apply for purposes of computing the taxable income and earnings and profits of the CFC with respect to its section 987 QBUs. In addition, the basis of assets and the amount of liabilities transferred directly or indirectly between a section 987 QBU and its owner[21] would be translated at the spot rate applicable on the date of the transfer after taking into account gain or loss recognized under Treas. Reg. § 1.988-1(a)(10).

Taxpayers would be permitted to make the CFC Election on an originally filed return (including extensions) for any tax year in which the rules in Section 5 of the 2026 Notice are applicable. Once made, the taxpayer could revoke the CFC Election only with the Commissioner's consent. A taxpayer would be required to make the CFC Election consistently for all CFCs controlled by the taxpayer and its related parties. Importantly, any unrecognized section 987 gain or loss that arose before the CFC Election is made would be recognized pro rata over 120 months beginning with the first month of the tax year in which the CFC Election is made.

In the case of an Inbound Transaction, rules would be provided to account for section 987(3) gain (but not loss) that has not been recognized as a result of the CFC Election. The 2026 Notice proposes that taxpayers must account for this gain by determining the CFC's inside basis in its assets increased (in U.S. dollar terms) due to currency fluctuations (which the 2026 Notice

[21] Generally, transfers between QBUs are treated as transfers from the QBU to its owner and from the owner to the recipient QBU. See Treas. Reg. § 1.987-2(c)(10), Example 2.

refers to as the "**section 987 basis increase**").[22] In principle, a transferor CFC's section 987 basis increase would represent the net amount by which the basis in the transferor CFC's assets increased due to currency fluctuations that would have been accounted for under section 987(3) had the CFC Election not been made.

The forthcoming guidance would provide rules requiring the amount of any section 987 basis increase to be recognized at the time of the Inbound Transaction or to be preserved for future recognition. Treasury and the IRS stated that they are considering the following three options: (1) the transferor CFC would recognize the amount of section 987 basis increase as section 987 gain immediately before the Inbound Transaction; (2) the domestic acquiring corporation would reduce its basis in assets acquired from the transferor CFC in the Inbound Transaction; or (3) if the Inbound Transaction causes the domestic acquiring corporation to become the owner of a section 987 QBU, the section 987 QBU's unrecognized section 987 gain or loss following the transaction would be adjusted to include the amount of the section 987 basis increase attributable to the activities of the section 987 QBU (such that the gain would be deferred and recognized by the domestic acquiring corporation under the rules of the 2024 Final Regulations, as modified by the 2026 Notice).

In addition, Treasury and the IRS stated that they are considering a framework in which a taxpayer may choose to compute a transferor CFC's section 987 basis increase under one of two options: (1) the transferor CFC's aggregate net unrecognized section 987 gain computed for a period of ten taxable years preceding the Inbound Transaction, using the simplified method provided in Treas. Reg. § 1.987-10(e)(3) (which could potentially be applied based on financial statement balance sheets instead of tax-basis balance sheets); or (2) excess asset basis with respect to the transferor CFC, as determined under Treas. Reg. § 1.367(b)-3(g)(2)(i).

[22] Under the 2026 Notice, the section 987 basis "increase" represents the calculation to determine the amount by which the QBU's basis in its assets is overstated due to unrealized economic currency appreciation. The adjustment proposed by the 2026 Notice is actually a decrease in the basis of the assets received by the transferee. We suggest changing the defined term to the "section 987 basis decrease" to reflect the consequence to the transferee and avoid confusion.

Treasury and the IRS also stated that they are also evaluating whether the cumulative translation adjustment ("**CTA**") (as computed for U.S. GAAP purposes with respect to the activities of the transferor CFC's section 987 QBUs for all taxable years in which the CFC Election is in effect) could be used as a reasonable proxy for the section 987 basis increase. For this purpose, several issues are being considered including whether the relevant portion of the CTA can be accurately determined and can be adjusted to eliminate amounts that are not properly taken into account under section 987(3) (for example, foreign currency gain or loss on net investment hedges).

The special rules for Inbound Transactions would apply only if a de minimis threshold were met (for example, based on the aggregate gross basis in all of the transferor CFC's assets in the hands of the domestic acquiring corporation immediately after the Inbound Transaction).

5. Applicability Dates and Reliance

The forthcoming proposed regulations, when finalized, are expected to apply to tax years ending on or after the date final regulations adopting the rules are published in the Federal Register. Taxpayers may rely on the rules described in Sections 3 and 4 of the 2026 Notice for a tax year ending before the proposed regulations are published in the Federal Register and to which the 2024 Final Regulations apply, provided the taxpayer and all members of its section 987 electing group (as defined in Treas. Reg. § 1.987-1(g)(2)(ii)) apply the rules in their entirety and in a consistent manner for the tax year and each subsequent tax year ending before the proposed regulations are published in the Federal Register.

Taxpayers may not rely on the rules described in Section 5 of the 2026 Notice relating to the application of section 987(3) to CFCs. However, Treasury and the IRS expect that taxpayers will similarly be permitted to rely on those rules in future guidance, and they "intend to issue this guidance in the near future to provide taxpayers with sufficient time to determine whether to make the CFC election for the 2025 [tax] year on an originally filed return (with extension)."

IV. Discussion of Recommendations

We generally agree with the framework of the rules, as described above, in Sections 3 and 4 of the Notice and have no specific recommendations with respect thereto. This Report focuses its recommendations on the CFC Election described in Section 5 of the Notice.

A. Mechanics and Timing of the CFC Election

As proposed, taxpayers would be permitted to make the CFC Election on an originally filed return (including extensions) for any tax year in which the rules in Section 5 of the 2026 Notice are applicable. Once made, the CFC election could only be revoked with the consent of the Commissioner. The 2026 Notice highlights the need for "special consistency rules" to address situations in which a CFC is acquired from an unrelated person (where the taxpayer has made the CFC Election but the seller has not, for example).

Recommendations: For the 2025 taxable year only, we recommend permitting taxpayers to make the CFC Election on an amended return filed before the original return due date (with extensions) for the 2026 taxable year. Even if regulations are proposed and issued relatively quickly after the consideration of comments submitted, this leaves a short period of time for taxpayers to assess the impact of the CFC Election. Because the CFC Election, if made, must be made consistently for all CFCs controlled by the taxpayer and its related parties, assessment of the merits of the election may cover a large number of QBUs and requires analysis of a number of factors in making the decision. For example, a taxpayer needs to assess the tax consequences of triggering the 10-year amortization of its unrealized section 987 gain or loss for all of its QBUs, taking into account not only the amount of such gains and losses, but their source, characterization, coverage by foreign tax credits, and impact on global interest expense allocation. The interaction of these factors is complex and likely requires time for creation and review of a model in order to reach a fully informed decision.

Depending on the taxpayer, deciding to make the CFC Election also may require input from multiple stakeholders within the organization, both within the tax function and across the larger organization. Non-tax functions potentially impacted by the decision include finance,

financial statement accounting, and corporate treasury (depending on the cash management and hedging activities related to the QBUs). Coordinating and assessing the feedback from these functions, which may depend on the completion of the quantitative assessment of the impact of the election, require time.

The timing for the 2025 election raises operational concerns as well. By the time regulations are proposed and issued, the annual corporate income tax return preparation process (which spans months for a complex multinational organization) may be far enough along to make changes difficult. Although the ability to make the CFC Election for the 2025 taxable year is welcomed, flexibility on the timing of the CFC Election for 2025 is likely to make the election viable as a practical matter for more taxpayers.

Further guidance is needed on the implications of making (or not making) the CFC Election for subsequent business combinations or dispositions (acquisitions or dispositions of CFCs and/or the U.S. shareholder). As background, under the 2024 Final Regulations, section 987 elections are not treated as methods of accounting.[23] The 2024 Final Regulations do, however, provide for consistency rules in the making or revoking of certain elections.[24] For example, a CFC that becomes a member of a section 987 electing group is deemed to make or revoke such elections necessary to conform the section 987 elections to those of the group.[25] Similarly, a specific rule applies the acquiring corporation's section 987 elections to acquired QBUs in the case of an asset acquisition described in section 381(a).[26] Guidance on the impact of the CFC Election, either on its own or as part of additional guidance applicable to the consistency requirements for section 987 elections more generally, would be important and welcome. Areas in which guidance would be helpful include:

[23] *See* Treas. Reg. § 1.987-1(g)(4).

[24] *See* Treas. Reg. § 1.987-1(g)(2).

[25] *See* Treas. Reg. § 1.987-1(g)(2)(ii).

[26] *See* Treas. Reg. § 1.987-1(g)(2)(iii).

- Application of the CFC Election if a CFC or its U.S. shareholder that has made the CFC Election is acquired by an acquirer that has not made the CFC Election (or acquisition of a CFC or U.S. shareholder that has not made the CFC Election by an acquiror that has), including whether deviation from the general section 987 election rules may be appropriate in some circumstances.[27]

- Impact of a departure of a CFC from a CFC group (e.g., through a sale of the stock of the CFC) on the outstanding amortization of the unrecognized section 987 gain or loss required when the CFC Election is made (for example, acceleration or carryover of the amortization)[28].

- Consequences of the CFC Election on an acquisition of a foreign target (CFC or QBU) for which U.S. taxes previously had not been relevant.

- Consequences of the revocation of the CFC Election, including the determination of the exchange rate to transition the CFC's opening QBU tax-basis balance sheet and the treatment of the unamortized section 987 gain or loss from the initial CFC Election if the revocation occurs within 5 years of the initial election.

- Timing for when CFC Election can be made after revocation (for example, 5 years after the revocation).

Finally, although not novel to the proposed CFC Election, the application of a consistency requirement across all CFCs controlled by the taxpayer and/or where the taxpayer and the members of its controlled group own a majority of the stock (by vote or value) determined at a

[27] For example, if the acquirer has made the CFC Election and the acquired CFC has not, does the 120-month amortization period begin as of the date of acquisition or is there a catch up back to the date of the acquirer's election? Are there situations in which it would be appropriate to reverse the presumption of which group's election controls (such as where the acquirer made the CFC Election because it had minimal operations in QBU form but acquires a group with many or larger QBUs)?

[28] For example, should the amortization of CFC's section 987 gain or loss cease at the time of the sale (similar to the treatment under Treas. Reg. § 1.987-10(e)(5)(ii)(B) for the amortization of pre-transition losses for certain nonrecognition transactions)? Should the result depend on whether the acquirer has made its own CFC Election or whether the unrealized amounts are gains or losses?

single point in time (at the end of the taxpayer's taxable year in which the CFC Election is made) may raises issues for non-controlling U.S. shareholders, situations in which majority ownership changes (for example, when the CFC is owned through a partnership) or other complex ownership structures.[29]

B. Manner of Taking into Account the CFC Basis Adjustment

Treasury and the IRS have a long-standing concern that taxpayers may inbound assets the basis of which reflects currency appreciation without the current or future recognition of the unrecognized appreciation. In the absence of additional guidance, the result that Treasury and the IRS describe is a product of two factors: (1) QBUs keep their books and records, and calculate their items of income, deduction, gain, or loss, in their functional currency under section 987(1) and 989 (meaning they have a basis in their assets and an amount of liability determined solely by reference to their functional currency); and (2) in the case of an inbound reorganization or liquidation involving a CFC or QBU of a CFC that has a functional currency other than the U.S. dollar, the basis of the CFCs assets and liabilities (including assets of its QBUs) are determined based on the spot rate on the date of the transaction.[30] The QBU's basis in its assets and the amount of its liabilities are translated at the spot rate in an inbound reorganization or liquidation because the applicable section 367(b) and section 987 regulations treat the CFC owner of a QBU as generally recognizing any unrecognized section 987 gain or loss.[31] As a consequence, the transferee has no unrecognized currency gain or loss immediately after the Inbound Transaction.

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[29] For example, what if there is no single controlling shareholder of the CFC? In the case of CFCs owned by partnerships comprised of unrelated partners, if control of the CFC changes over time because of shifts in the ownership percentage of the unrelated partners, does this change the CFC Election effective for the CFC? Should the result change if the CFC is owned through multiple levels of partnerships (such as one or more investment funds)?

[30] Treas. Reg. § 1.367(b)-2(j)(1).

[31] Treas. Reg. § 1.367(b)-2(j)(1) (requiring the CFC or QBU to make the adjustments required under Treas. Reg. § 1.985-5 for a change in functional currency immediately before the inbound reorganization or liquidation, including (i) determining the transferee's basis of assets and amount of liabilities by computing the product of the old functional currency adjusted basis or liability amount and the new functional currency/old functional currency spot rate immediately before the exchange and (ii) the recognition of any unrecognized section 987 gain or loss). Additionally, a QBU of a CFC would generally be considered to terminate under the rules of Treas. Reg. § 1.987-8 in an inbound reorganization. So, assume for example a USD functional currency CFC owns a euro functional

The underlying assumption for the application of the spot rate basis translation rule is that any unrecognized section 987 gain or loss is recognized. However, an inbounding of a QBU generally would cause the QBU to terminate immediately before the inbounding, and, in the absence of the application of section 987(3) pursuant to the CFC Election, potentially result in a step up in asset basis without the imposition of tax. In other words, because section 987(3) has not been applied by the CFC on the deemed termination of the QBU, any currency related appreciation or depreciation of the assets (and liabilities) of the QBU vis-à-vis the CFCs functional currency effectively would not be computed or recognized on the Inbound Transaction.

Once the amount of basis in the CFC's assets attributable to unrecognized currency appreciation is determined, the 2026 Notice considers three options for taking such amount into account: (1) calculate and recognize the section 987(3) gain immediately before the Inbound Transaction (similar to the current law treatment at the time of an inbound reorganization or liquidation under Treas. Reg. § 1.367(b)-2(j) and Treas. Reg. § 1.987-8 as described above); (2) reduce the basis of the assets acquired in the hands of the domestic acquiring corporation (a "**CFC section 987 basis reduction**"[32]); or (3) if the QBU remains a QBU in the hands of the domestic acquiring corporation, adjust the amount of unrecognized section 987 gain or loss in the hands of the domestic acquiring corporation by the amount of the section 987 basis adjustment (such that the gain would be deferred and recognized by the domestic acquiring corporation under the rules of the 2024 final regulations, as modified by the Notice).

currency QBU. Assume further that in year 1 the QBU was capitalized with $100 of cash, which at that time equaled €100. If in year 2 the CFC undergoes an inbound reorganization at a time when €100 equals $120, the domestic transferee would take $120 basis in the euro cash. Similarly, if the cash had been remitted immediately before the inbound reorganization (i.e., also at a time when €100 equals $120) the CFC would have a $120 USD spot rate basis per sections 5.02 and 3.07(3) of the 2026 Notice.

[32] As noted above, we suggest describing the basis adjustment as a reduction rather than a section 987 basis "increase" to avoid confusion.

Recommendation: We recommend treating the calculated amount as a reduction of the CFC's inside basis in its assets immediately before the transaction (i.e., option 2 above). Reducing the basis of the assets received in the hands of the domestic acquiring corporation to account for the unrecognized section 987 gain is the most consistent with the purposes of both the CFC Election and the special Inbound Transaction rules. The section 987 basis adjustment rule is intended to ensure that the transferee effectively does not obtain a basis increase attributable to the unrecognized section 987 gain by requiring an offsetting downward basis adjustment. Reducing the basis of the assets of the domestic acquiring corporation to account for the unrecognized section 987 gain rather than requiring current recognition of gain (option 1) would be most consistent with the treatment of any unrecognized gain not attributable to foreign currency movement in an inbound asset reorganization or liquidation described in Treas. Reg.§ 1.367(b)-3(a) (i.e., such gain is deferred and ultimately recognized by the transferee). Further, the scenario contemplated by option 3 might not always be applicable (i.e., a section 987 QBU of the CFC may not always be a section 987 QBU with respect to the domestic transferee).

The effect of the CFC section 987 basis reduction could be viewed as converting what otherwise represents section 987 foreign currency gain into unrecognized gain of a different character and source. We suggest considering whether additional rules are needed to prevent abuse and/or unintended consequences. For example, to prevent the change in nature of source or character of income, Treasury and the IRS could consider rules that apply the source and character rules of Treas. Reg. § 1.987-6 to characterize the amount of the unrecognized gain immediately before the transaction to preserve the source and character of the unrecognized gain be preserved in the hands of the domestic transferee. As one example, if a $20 basis adjustment is made to reflect $20 of unrecognized section 987 gain at the time of the Inbound Transaction,[33] such a rule could characterize $20 of unrecognized gain under the rules of Treas. Reg. § 1.987-6 and preserve this character of the gain in the hands of the transferee when the transferee later recognizes such gain. If the $20 of unrecognized gain is characterized as, say,

[33] See footnote 31, *supra*.

entirely section 951A income, such character and source should apply upon the ultimate recognition of the gain by the domestic transferee.

C. Calculation of the Amount of the CFC Section 987 Basis Reduction

The basis reduction (or recognition of section 987 gain if our recommendation were not adopted) depends on calculating the amount of unrecognized section 987 gain. The 2026 Notice provides a framework under which a taxpayer may compute the transferor CFC's section 987 basis increase:

- Using the transferor CFC's aggregate net unrecognized section 987 gain computed for the period ten taxable years preceding the Inbound Transaction, or
- Excess asset basis with respect to the transferor CFC, as determined under Treas. Reg. § 1.367(b)-3(g)(2)(i).

We note that Treasury and the IRS are also considering whether the CTA as computed for U.S. GAAP purposes as a proxy for the unrecognized section 987 gain or loss. [34]

Recommendations: We commend retaining flexibility in the methods used by taxpayers in calculating a CFC's section 987 basis increase. Each of the two primary proposals in the 2026 Notice for the computation of the CFC section 987 basis increase requires detailed record-keeping by taxpayers in advance of the Inbound Transaction, minimizing the administrative benefit of the CFC Election. We recommend that any method adopted for the adjustment depend solely on information available to the taxpayer without the need for the taxpayer to run a full section 987 calculation.

In particular, the 2026 Notice acknowledges that financial statement balance sheets potentially could be used instead of tax-basis balance sheets. It would be helpful to clarify which tax adjustments (if any) would need to be made to the financial statement balance sheets (such as adjusting for disregarded transactions and removing stock of subsidiaries). If such

[34] Notice 2000-20 (soliciting comments on whether, and the manner in which, the section 987 regulations should be more closely harmonized with financial accounting principles, "either for policy reasons or to reduce the administrative burden of complying with the regulations.")

balance sheets could be used on an unadjusted basis, this would minimize the need to use CTA as a proxy for unrecognized section 987 gain or loss.

Providing the option to compute excess asset basis, as determined under Treas. Reg. § 1.367(b)-3(g)(2)(i), also helps address the administrative burden associated with recreating section 987 estimates in the year of an Inbound Liquidation. The excess asset basis test requires three sets of information: (1) E&P of the CFC (translated into U.S. dollars under section 986(b)); (2) outside basis in the shares of the CFC; and (3) the aggregate amount of liabilities of the foreign acquired corporation that are assumed (determined under the principles of section 357(d)). Although assembling this information may pose its own challenges, the burden may be less than a full section 987 calculation.

For these reasons, having the option to use CTA as a reasonable proxy for the unrecognized section 987 gain would be impactful for taxpayers in achieving the reduction of taxpayer burden the CFC Election is proposed to achieve. We note that the 2026 Notice raised a variety of concerns in utilizing CTA without adjustment (for example, without eliminated disregarded transactions). Although a detailed review of the principles for calculating CTA under U.S. GAAP is beyond the scope of this Report, we believe the concerns may be addressed by adopting a rule similar to the section 985 rule for when the U.S. GAAP functional currency can be used for U.S. federal income tax purposes.[35] That is, CTA could be used if the CTA methodology is substantially similar to a section 987 computation. Further, such a rule could provide specific exceptions or adjustments (for example, removing adjustments from CTA related to net investment hedges entered into by entities other than the CFC or other items not related to the QBU's balance sheet) for aspects of CTA clearly not substantially similar to the computation of unrecognized section 987 gain, which would permit taxpayers to potentially use the "adjusted" CTA methodology if it is substantially similar to a section 987 computation.

[35] Instead of writing prescriptive rules, Treas. Reg. § 1.985-1(c)(5) provides that "the currency of the QBU for purposes of United States generally accepted accounting principles (GAAP) will ordinarily be accepted as the functional currency of the QBU for income tax purposes, provided that the GAAP determination is based on facts and circumstances substantially similar to those set forth in [Treas. Reg. § 1.985-1(c)(2)]."

D. De Minimis Threshold

The 2026 Notice proposes that the section 987 basis increase calculation is only required if a de minimis threshold is met. The 2026 Notice further suggests an exception based on the aggregate gross basis of all of the transferor CFC's assets in the hands of the domestic acquiring corporation immediately after the Inbound Transaction.

Recommendation. In addition to a de minimis rule based on the amount of the aggregate gross basis of assets, consideration should be given for an additional rule using a proxy for the potential amount of section 987 basis increase. Regarding the latter, a rule utilizing unadjusted CTA (i.e., without adjustments for any tax-related items), may be a good enough proxy to determine the size of unrecognized section 987 gain or loss for applying a de minimis threshold and administratively easier to apply.

E. Coordination with Section 362(e)(1) and Section 367

The 2026 Notice solicits comments on how the section 987 basis increase rules should interact with other provisions that may be applicable to inbound reorganizations and liquidations (such as section 362(e)(1) and section 367(b)).

Recommendation. As an ordering rule, the section 987 basis adjustment ought to be computed and taken into account in determining the basis of property before the application of other provisions applicable to inbound reorganizations and liquidations such as section 362(e). The proposal is consistent with the treatment of section 987 gain or loss in the case of an inbound reorganization or liquidation.[36] It is also consistent with the provisions of Section 362(e)(1) that determine whether a transaction effects a loss importation by reference to the acquiring corporation's basis in imported assets *immediately after* the transaction.[37]

[36] See, e.g., Treas. Reg. §§ 1.367(b)-2(j), 1.987-8.

[37] Treas. Reg. § 1.367-3(c)(3).