February 12, 2024

The Honorable Lily Batchelder
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Mr. William Paul
Principal Deputy Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Comments on Proposed Regulations under Section 987, Income and Currency Gain or Loss With Respect to a Qualified Business Unit

Dear Ms. Batchelder and Mr. Paul:

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) to publish proposed regulations under section[1] 987 ("proposed regulations"), regarding income and currency gains and losses with respect to a qualified business unit (QBU). On behalf of the AICPA, we are providing recommendations on these proposed regulations.

Overview

The 2016 final regulations retained the foreign exchange exposure pool (FEEP) method contained in the 2006 proposed regulations but modified those regulations to make it easier for the IRS to administer. The 2016 final regulations required taxpayers to transition using the fresh start transition method, under which any section 987 gain or loss that would have been recognized under the taxpayer's prior method as a result of the deemed termination was neither recognized nor carried forward as net unrecognized section 987 gain or loss. Further, for purposes of applying the FEEP method in the first year in which the regulations apply, the asset and liabilities of the section 987 QBU (including marked assets and liabilities) were translated using historic rates without adjustment.

Comments stated that the fresh start transition method is difficult to apply because taxpayers did not track historic rates before the transition date, and the data needed to determine the historic rates for items acquired in prior taxable years is not readily available. In addition, comments asserted that the fresh start method imposed an undue financial burden by permanently eliminating unrecognized section 987 losses determined before the transition date.

The proposed regulations provide a new transition rule that replaces the 2016 final regulations fresh start methodology, which accounts for the unrecognized section 987 gain or loss accrued

[1] All references to "section" are to the Internal Revenue Code of 1986, as amended, and all references to "Treas. Reg. §", "Prop. Reg. §", and "regulations" are to U.S. Treasury regulations promulgated thereunder, unless otherwise specified.

1455 Pennsylvania Ave. NW, Washington, DC 20004-1081
T: +1 202.737.6600 F: +1 202.638.4512
aicpaglobal.com | cimaglobal.com | aicpa.org | cgma.org

before the transition date. In addition, the new transition rule would not require taxpayers to retrospectively determine historic rates for items acquired before the transition date.

For purposes of computing the pretransition gain or loss, taxpayers are bifurcated between those using an eligible pretransition method and those that were not on an eligible section 987 method.

A taxpayer that applied section 987 before the transition date using an eligible pretransition method would use that method to compute their pretransition gain or loss. Pretransition gain or loss generally is equal to the amount of section 987 gain or loss that would have been recognized under the eligible pretransition method if the QBU terminated on the day before the transition date. A taxpayer that did not apply an eligible pretransition method before the transition date would determine pretransition gain or loss using the method provided in Prop. Reg. § 1.987–10(e)(3) modified FEEP method. Under this method, pretransition gain or loss is equal to the sum of the annual amounts of unrecognized section 987 gain or loss for each taxable year since the section 987 QBU's inception, reduced by any section 987 gain or loss recognized before the transition date.[2]

Recommendations

The AICPA requests that Treasury and the IRS consider the following recommendations when finalizing the regulations under section 987:

1. Implement a de minimis threshold for the requirement to recompute pretransition gain or loss, under the modified FEEP method for QBUs without an eligible pre-transition method.

2. Include guidance providing that, with respect to QBUs held by a controlled foreign corporation (CFC), for purposes of determining whether an earnings only method under Prop. Reg. § 1.987-10(e)(4)(iii) qualifies as an eligible pretransition method "applied consistently to all section 987 QBUs of the owner" if the owner has applied the earnings only method consistently for each year since the enactment of the Tax Cuts and Jobs Act of 2017 (TCJA).

3. Alternatively, provide a cutoff period for the computation of the annual unrecognized section 987 gain or loss for each taxable year, to commence post-TCJA (2018 and 2019 for calendar and fiscal year taxpayers respectively) when the adjustments became relevant for most multinational taxpayers.

Analysis

Taxpayers have employed a myriad of approaches with regards to section 987 gain or loss computations, including adopting the proposed regulations issued in 1991, earnings only, 2006 proposed regulations, and the 2016 final regulations. Other taxpayers abstained from adopting any methodology, reasoning that any adjustments required under section 987(3), those "prescribed by the secretary" were not effective until the regulations are finalized.

[2] Proposed Reg. § 1.987–10(e)(3)(ii).

Some taxpayers only adopted section 987 methodology after the Tax Cuts and Job Act of 2017 ("TCJA"), as the adjustments became relevant to U.S. shareholders that owned a section 987 QBU through a controlled foreign corporation.[3] These taxpayers deemed the section 987 gain or loss as immaterial for all years prior to the enactment of the TCJA provisions.

Given the divergence in application of the regulations under section 987 prior to the release of the proposed regulations, the AICPA recommends that Treasury and the IRS reconsider the transition rule for small taxpayers that did not apply an eligible pretransition method. These taxpayers would be required to compute their pretransition gain or loss, under the modified FEEP method by determining for each period since the QBU's inception, the annual unrecognized section 987 gain or loss reduced by any recognized section 987 gain or loss before the transition date, with the latter requiring amending returns due to no fault on their part.

To compute the annual unrecognized section 987 gain or loss, taxpayers would need to have access to prior year financial statements for the QBUs, that may not be available and would be administrative burdensome to recreate. With the confluence of the TCJA international provisions, corporate alternative minimum tax ("CAMT"), organization for economic co-operation and development ("OECD") Pillar one/two implementation, and the sunsetting of TCJA provisions in 2025, taxpayers will be required to juggle and prioritize these provisions whilst simultaneously reducing headcount from a cooling economy.

Small taxpayers that ventured into foreign markets to remain competitive in the global marketplace would be required to make difficult decisions to the extent the required period financial statements are not readily available. As such, small taxpayers that have not adopted an eligible pretransition method, or abstained in the absence of final regulations, would be unduly burdened with computing their pretransition gain or loss per section 987 QBU from the formation date.

The AICPA appreciates the Treasury and IRS's replacement of the fresh start transition method, which utilizes a modified FEEP for taxpayers under an ineligible method. Therefore, to alleviate the administrative burden, the AICPA recommends a de minimis threshold be implemented for the requirement to compute pretransition gain or loss under Prop. Reg. § 1.987-10(e)(3). This would reduce the administrative burden for small taxpayers and the Treasury and IRS.

We note that a similar de minimis threshold is already utilized by Prop. Reg. § 1.987-12(a)(3)(ii), which provides that the deferral of section 987 gain or loss does not apply in a taxable year if the aggregate amount of net unrecognized section 987 loss of the owner with respect to all of its section 987 QBUs that would become deferred section 987 gain or loss does not exceed $5 million.

Proposed Reg. § 1.987-10(e)(4)(iii) provides that an earnings only method (which determines section 987 gain or loss only with respect to the earnings of a section 987 QBU) that does not meet the requirements of Prop. Reg. § 1.987-10(e)(4)(ii) is an eligible pretransition method, provided that, among other requirements, "The earnings only method was applied consistently to all section 987 QBUs of the owner."

[3] Treasury Reg. § 1.964-1(a)(2).

As described above, some taxpayers only adopted a section 987 methodology after the TCJA as the adjustments became relevant to U.S. shareholders that owned a section 987 QBU through a CFC. Treasury Regulation § 1.964-1(a)(2) provides that no adjustment shall be required for purposes of determining the earnings and profits (E&P) of a foreign corporation unless it is material. Some taxpayers determined the section 987 gain or loss of QBUs held by the CFC to be immaterial for all years prior to the enactment of the TCJA provisions and, as such, did not make E&P adjustments under section 987.

The requirement to calculate pretransition gain or loss under the FEEP method pursuant to Prop. Reg. § 1.987-10(e)(3) represents a punitive and burdensome requirement for taxpayers that previously acted in compliance with the applicable regulations. This requirement is particularly burdensome on small taxpayers. Thus, we recommend that the final regulations include an example or other guidance providing that, with respect to QBUs held by a CFC, for purposes of determining whether an earnings only method under Prop. Reg. § 1.987-10(e)(4)(iii) qualifies as an eligible pretransition method "applied consistently to all section 987 QBUs of the owner" if the owner has applied the earnings only method consistently for each year since the enactment of the TCJA (i.e., 2018 and 2019 for calendar year and fiscal year, respectively).

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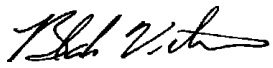
We appreciate your consideration of our recommendations and welcome the opportunity to further discuss our comments. If you have any questions, please contact Chaya Siegfried, Chair of International Tax TRP, at (732) 842-3113, or csiegfried@withum.com, Reema Patel, Senior Manager - AICPA Tax Policy & Advocacy, at (202) 434-9217, or reema.patel@aicpa-cima.com; or me at (830) 372-9692 or bvickers@alamo-group.com.

Sincerely,



Blake Vickers, CPA, CGMA
Chair, AICPA Tax Executive Committee

cc: The Honorable Daniel I. Werfel, Commissioner, Internal Revenue Service
Mr. Peter Blessing, Associate Chief Counsel, International, Internal Revenue Service
Ms. Lindsay Kitzinger, Office of the International Tax Counsel, Department of the Treasury
Mr. Jim Wang, Deputy International Tax Counsel (Acting), Office of the International Tax Counsel, Department of the Treasury
Ms. Elena Virgadamo, Office of the International Tax Counsel (Treaty Affairs), Department of the Treasury