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March 11, 2025

Internal Revenue Service
1111 Constitution Ave. NW
Washington, DC 20224

Via online submission

RE: New Proposed Section 987 Regulations [REG-117213-24]

Dear Sir or Madam:

The U.S Department of the Treasury ("Treasury") and Internal Revenue Service (the "Service," together with Treasury, the "Government") published proposed regulations under section 987 (the "Proposed Regulations") on December 11, 2024. The Proposed Regulations provide guidance regarding the determination of section 987 foreign currency gain or loss on certain disregarded transactions between a qualified business unit ("QBU") and its owner. The Government requested interested stakeholders submit comments by March 11, 2025. I am pleased to respond to the Government's request for comments on behalf of Tax Executives Institute, Inc. ("TEI").

About TEI

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 56 chapters in North and South America, EMEA, and Asia. TEI, as the preeminent association of in-house tax professionals worldwide, has a significant interest in promoting sound tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our more than 6,000 individual members represent over 2,800 of the leading companies in the world.

TEI Comments

TEI commends the Government for issuing the final section 987 regulations on December 10, 2024 ("Final 987 Regulations"). While some concerns remain about the full adherence of some aspects of the regulations to the statute, especially in the absence of taxpayers making allowable elections, taxpayers generally welcome the overall clarity provided in the Final 987 Regulations, which addressed key and at times longstanding taxpayer concerns. We note that in most cases the guidance contained in the Final 987 Regulations is reasonable and, crucially, administrable for taxpayers.

We therefore consider it important that the Final 987 Regulations remain effective, as their repeal would result in reverting back to the reporting and administrative ambiguity existing since the 1990s. We welcome conversations with Treasury and the opportunity to provide further input as needed, prior to Treasury taking any action impacting the effectiveness or applicability of the Final 987 Regulations.

1. Including Certain Intercompany Financing Transactions within Scope of Recurring Transfer Group Election

The Proposed Regulations' Preamble (the "Preamble") requests comments regarding what other transfers should be included in the "recurring transfer group" election. Such transfers would be translated using the yearly average exchange rate rather than the spot rate applicable on the date of the transfer, under Prop. Treas. Reg. § 1.987-2(f)(1). This election would significantly simplify unrecognized section 987 gain and loss computation and reporting under Treas. Reg. § 1.987-4 for these types of disregarded transactions between qualified business units and their owners.

Treasury specifically requested comments as to whether intercompany lending transactions should be included in the recurring transfer group election. The Preamble mentions intercompany lending transactions of banks and other financial entities as transactions that should be included in the election because such lending transactions are made in the ordinary course of business. Other taxpayers with large numbers of entities in their structure, however, also routinely rely on short-term intercompany lending transactions as part of their day-to-day cash funding needs across business divisions or jurisdictions. For example, many multinationals use cash-pooling structures for short-term funding, under which short-term cash pool borrowings ("draws") or deposits to a cash pool header such as an in-house bank ("IHB") occur on a daily basis.[1] These deposits or draws are often driven by cash that section 987 qualified business units ("QBUs") use or receive for inventory purchases and sales, payments for services, as well as rental and royalty payments. The recurring transfer group ("RTG") election currently includes these types of transactions. Therefore, to the extent these cash pooling transactions occur between QBUs and their owners or between QBUs under the

[1] IHB cash-pooling activities can be afforded similar treatment under other sections of the Code as that afforded to financial entities, such as the ability to elect dealer status under section 475(c)(1) pursuant to the "negligible sales" exception because they regularly purchase securities from customers in the ordinary course of a trade or business even if they do not transact with external parties. While transactions between a third-party bank and a QBU would not be considered a contribution/remittance for purpose of the section 987 regulations, transactions between QBUs and an IHB may be considered contribution/remittances. Thus, other than dealing with external parties, IHB activities are similar to those of a financial entity and excluding intercompany cash pooling activities penalizes transactions with IHBs by making them more administratively burdensome from a section 987 perspective than other routine intercompany transactions captured in the RTG definition.

same owner, we recommend they be included in the definition of RTG under Prop. Treas. Reg. § 1.987-2(f)(2).

Failure to include intercompany lending within the RTG election would create a disproportionate advantage for QBUs transacting with third-party banks for cash pooling. Such transactions are not contributions/remittances subject to tracking whereas QBU taxpayers pooling with their IHB are subject to tracking under the Proposed Regulations. Including intercompany lending transactions within the scope of the RTG election provides relief from this burden and minimizes the noted disproportionate disadvantage for many taxpayers. Extending the election to intercompany lending would be consistent with the stated purpose of the Proposed Regulations to reduce the compliance burden of the section 987 regulations by allowing the use of the yearly average exchange rate in certain situations.[2]

2. <u>Including Other Recurring Ordinary Course of Business/Routine Transactions within the Scope of the RTG Election</u>

Other transactions that do not fall within the definition of the transactions listed in Treas. Reg. § 1.987-2(f)(2) (i.e., sales of inventory, and payments for services, rents, and royalties), can take place in a QBU's ordinary course of business. For example, in addition to transactions described in the prior section (i.e., cash-pooling and interest payment transactions), QBUs engage in other recurring ordinary course of business transactions with their QBU owners or other QBUs of the same owner. These transactions include reimbursement of certain expenses or costs, utilities, insurance, recurring asset transfers, and other fees. Accounting for these transactions under the Final Regulations will also create significant compliance burdens. Because any section 987 abuse from such transactions is unlikely, we recommend Treasury include a broader category in the list under Prop. Treas. Reg. § 1.987-2(f)(2) for other similar transactions to the ones listed that are recurring and part of a QBU's ordinary course of business.

3. <u>Make the RTG Election Available when Net Value Computations are Used Under Treas. Reg. § 1.987-4(e)(2)(iii).</u>

Prop. Treas. Reg. § 1.987-2(f)(5)(ii) provides that the RTG election does not apply to a QBU in the year in which an owner determines the QBU's net value under the alternative formula without preparing an adjusted balance sheet. However, having to track the different spot rates for each transfer treated as a recurring transaction for purposes of computing the QBU's net value would create an incremental unnecessary burden for taxpayers and would not address distortions of overall unrecognized 987 gains and losses. Therefore, we request removing the exception from the Proposed

[2] The Preamble states "permitting taxpayers to use the yearly exchange rate in lieu of the applicable spot rate would reduce the compliance burden of the section 987 regulations."

Regulations, to allow the RTG election to apply to the QBU net value computation under Treas. Reg. § 1.987-4(e)(2)(iii).

4. Application of Section 987(3) and Related Regulations to Controlled Foreign Corporations ("CFCs")

a. Considerations for Exempting CFCs from Application of Section 987(3)

The Preamble requests comments regarding whether the Final 987 Regulations should be modified so section 987(3) and its related regulations do not apply to CFCs. TEI agrees the final regulations should be modified to exclude CFCs from the application of Section 987(3), provided they are still subject to computing and translating taxable under sections 987(1) and (2).

Section 987(3) itself gives Treasury the discretion to determine what constitutes a "proper adjustment" to account for transfers of property between QBUs. In most cases, we believe that foreign exchange gains or losses attributable to section 987 QBUs of CFCs would still be captured through appropriate basis adjustments or under section 959 and section 986(c) at the time any earnings are permanently distributed to the U.S. shareholder. This is similar to when section 959 previously taxed earnings and profits ("PTEP") in various currencies tiers up through a CFC chain without incremental inclusion of currency gains and losses before reaching the U.S. parent. Importantly, removing the section 987(3) application from the outbound QBU context provides an opportunity for Treasury to simplify guidance without compromising on overall economics

The summary below highlights the difference in treatment between outbound QBU and CFC-to-CFC contexts for an otherwise identical economic and structural fact pattern. For ease of understanding, we compare (i) a USD parent of a EUR CFC holding a GBP QBU, to (ii) a USD parent of a EUR CFC holding a GBP CFC.

- Remittances of Contributions: While a CFC to QBU contribution and subsequent remittance from the QBU to the CFC under section 987(3) of contributed capital creates an income recognition event at the CFC level, a similar section 351 contribution / section 301(c)(2) distribution of basis between CFCs would not result in income recognition at the CFC level.

- Remittances of Inclusions under Subpart F/GILTI: While a remittance out of the equity pool (comprised of contributions and net income, whether taxed or untaxed) from a QBU to a CFC under section 987(3) creates an income recognition event at the CFC level, a similar distribution (or tiering up) of section 959(c)(1) and (2) PTEP between CFCs would not result in a P&L recognition event at the CFC level. As discussed above, there is no guidance akin to a section 986(c) inclusion event at the CFC level in the CFC-to-CFC context, while there is guidance that calls for an inclusion event in the QBU to CFC context, under section 987(3).

- Remittances of Untaxed Earnings: While a remittance out of the equity pool (comprised of contributions and net income, whether taxed or untaxed) from a QBU to a CFC under section 987(3) creates a recognition event at the CFC level, a similar distribution (or tiering up) of section 959(c)(3) earnings between CFCs would not create a recognition event at the CFC level.

We understand that the Government's concern that inside and outside basis differences could create opportunities to import "excess" basis to the United States. We acknowledge this concern where taxpayers engage in certain reorganizations identified by the Service or in other transactions aimed at creating excess asset basis. However, it is unclear how removing CFCs from the scope of section 987(3) would make excess asset basis more prevalent, given the volatility and unpredictability of foreign exchange markets. In any event, Treasury has addressed the concern with inbounding excess basis through other regulations, such as the 2016 loss importation rules.[3]

Admittedly, excluding CFCs from section 987(3) may lead to shifts in the timing and characterization of foreign exchange gains and losses. However, such changes could be favorable or unfavorable to taxpayers depending on their specific circumstances and are generally difficult to manipulate. Instead, the Government should rely on non-section 987 provisions applicable at the CFC level to capture foreign exchange gains and losses from outbound QBUs to reduce opportunities for selective gain and loss recognition through disregarded remittances. Notably, if a taxpayer does not recognize foreign exchange gains and losses on a mark-to-market basis (for instance, by not making an ARE election under the Final Regulations), it could, in theory, time inclusions of gains or losses for tax optimization, despite the "loss to the extent of gain" limitation. Consequently, removing the requirement to remeasure section 987 gains or losses at the CFC level may, in fact, further mitigate the Service's concerns regarding tax planning strategies such triggering artificial losses in a particular year.

In sum, applying section 987(3) to CFCs imposes an unnecessary compliance and administrative burden on taxpayers, requiring them to track adjustments for transfers between a QBU and its owner and to determine foreign currency gains or losses related to such transfers. Given the absence of tangible benefits for either taxpayers or Treasury, as outlined above, eliminating this requirement would enhance efficiency without undermining policy objectives.

b. Gain and Loss Considerations for Transition Rules

We welcome the proposed exclusion of CFCs from section 987(3). If the Government adopts this proposal, we recommend Treasury provide guidance on how the exclusion would impact pre-

3 *See* T.D. 9759 (Mar. 28, 2016) providing for limitation on the importation of net built-in losses.

transition section 987 gains or losses under the Final 987 Regulations. Treasury should address the following questions in any such guidance:

(i) Are unrecognized pre-transition section 987 gains and losses recognized, preserved, and subject to the Final 987 Regulations, or should Treasury adopt a fresh-start approach?

(ii) If pre-transition gains and losses are recognized or preserved, are they recognized or will they be recognized at the CFC level or directly by the US shareholder?

(iii) If pre-transition gains and losses are recognized and an amortization election is made under the Final 987 Regulations, does the amortization occur at the CFC level or directly at the US shareholder level?

(iv) How would the Treas. Reg. § 1.987-12 deferral rules apply to pre-transition gains and losses in this scenario? For example, assuming an amortization election is made, would all pre-transition gains and losses be recognized at the U.S. shareholder level upon a deferral event such as if a CFC with a QBU liquidates into its U.S. parent?

5. Considerations for Applying Section 987(3) to QBUs

Should section 987(3) continue to apply to CFCs despite the considerations noted above, we recommend Treasury reconsider the Final 987 Regulations' mandate requiring use of the asset method to determine the character and source of section 987 gains or losses of CFCs. Treasury should instead permit taxpayers to elect the modified gross income ("MGI") method under Treas. Reg. § 1.987-6(b). Taxpayers are already allowed to elect to use the MGI for purposes of interest expense allocation of CFCs under Temp. Treas. Reg. § 1.861-9T, and many do, making this a more administrable alternative for purposes of section 987 without compromising the economic outcomes. We do not see a policy reason as to why a similar election should not be allowed for purposes of section 987 gain or loss sourcing and characterization.

Indeed, the Final 987 Regulations create several elections simplifying the requirement to maintain a full tax basis balance sheet for section 987 purposes. However, forcing taxpayers to source and characterize CFC section 987 gains or losses following the asset method would require them to maintain an annual tax basis balance sheet for their CFCs where they may not otherwise do so, except for purposes of determining gains or losses for specific restructurings or other transactions. In addition, many QBUs have mixed use assets that produce multiple categories of income. Without revised guidance, compliance with current guidance would require taxpayers to find a way to split such assets between different income categories, such as by using gross income.

As was mentioned in comments submitted when the Final 987 Regulations were proposed, for most companies the most readily available information is a U.S. GAAP basis balance sheet (unadjusted for book-to-tax differences, disregarded transactions, etc.). Thus, a significant compliance burden would be imposed on companies to recreate tax basis balance sheets accounting for adjustments under the Final 987 Regulations and Proposed Regulations, especially if the companies do not already apply the asset method for interest expense allocation and instead elect to use the MGI method.

The Preamble to the Final 987 Regulations stated that the MGI method may result in more year-to-year variance in the source and character of section 987 gains or losses, including by reason of extraordinary events or because of tax planning. However, it is unclear why this same concern does not arise when applying the asset method, as taxpayers may have significant reductions or increases in certain types of assets (e.g., cash, investments in other CFCs) from year to year, also as a result of extraordinary events or transactions, which would similarly have a significant impact on character and source of section 987 gains and losses. Further, under either approach, taxpayers are unlikely to modify the nature of their assets or the nature of their income to generate a benefit for section 987 purposes at the CFC level. In particular, the currency markets are unpredictable and allocating gains and losses to different inclusion categories may at times be a benefit and at times be a detriment to taxpayers. To emphasize the argument in section 2.a. above, irrespective of the impact at the CFC level, ultimately the balances will be subject to remeasurement and inclusion at the U.S. level.

In sum, if section 987(3) continues to be applicable to foreign corporations, we recommend that taxpayers be permitted to elect the MGI method for purposes of determining the character and source of section 987 gains and losses under Treas. Reg. § 1.987-6(b).

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TEI appreciates the opportunity to comment on the Proposed Regulations. Should you have any questions regarding TEI's comments, please do not hesitate to contact Andreia Verissimo, Chair of TEI's Task Reform Task Force, at alveriss@amazon.com or Benjamin R. Shreck of TEI's Legal Staff at bshreck@tei.org or 202.464.8353.

Respectfully submitted,

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