February 12, 2024

Internal Revenue Service
CC:PA:01:PR (REG–132422–17)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: National Foreign Trade Council Comments on REG-132422-17

The National Foreign Trade Council (the "NFTC") is writing to provide comments on REG-132422-17, "Income and Currency Gain or Loss With Respect to a Qualified Business Unit; Correction" (the "Proposed Regulations") released by the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") on November 14, 2023, and amended on December 6, 2023.

The NFTC, organized in 1914, is an association of U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Our members support establishing and maintaining international tax norms that provide certainty to enterprises conducting cross-border operations.

General Comments

The Proposed Regulations address section 987 and largely retain the Foreign Exchange Exposure Pool ("FEEP") method from prior proposed regulations released in 2006 and 2016 for determining section 987 taxable income or loss and currency gain or loss with respect to qualified business units ("QBUs"). Below, we provide requests for clarifications and additional guidance. We understand the transition to a more standard method is intended to provide simplifications for both tax administrators and taxpayers. However, we request that Treasury and the IRS revisit the decision to eliminate the Earnings and Capital Method. These regulations reduce some of the concerns with the prior iteration of section 987 proposed regulations, but the compliance burden of preparing both U.S. dollar and local currency books for each QBU is still present.

Specific Comments

Compliance Simplifications

The Proposed Regulations specify that for purposes of computing the pre-transition gains and losses that certain methods will continue while other methods are no longer eligible. In order to help smooth the transition to a new method, NFTC requests that taxpayers be provided a ten-year (or shorter) cut-off date from which they must apply the pre-transition rules. Failure to provide such an accommodation will result in an additional compliance burden, including calculating the historical basis for assets which may stem from an investment decades ago or an acquisition in which the current taxpayer has no or limited knowledge of the historical basis. Furthermore, taxpayers which have records of this information are likely in U.S. GAAP. Therefore, records would need to be created to utilize the transition rule, creating another compliance burden.

Further Simplification for Taxpayers Applying 1991 Proposed Regulation Method

The NFTC recommends that the regulations permit taxpayers that have been applying the method described in the 1991 Proposed Regulations (the "Earnings and Capital Method") continue to apply this method so long as the taxpayers make the Current Rate Election ("CRE") and Annual Recognition Election ("ARE"). The Earnings and Capital Method aligns with the accounting for foreign currency gain or loss under prevailing financial accounting rules and therefore is simple to implement. This is particularly the case for taxpayers that have been utilizing the Earnings and Capital Method for many years. While the IRS and Treasury have identified inappropriate results stemming from the application of the Earnings and Capital Method (e.g., the asymmetric recognition of losses through selective remittances or branch terminations), conditioning the application of this method on the CRE and ARE provides adequate guardrails to prevent these inappropriate results. Even greater simplification and compliance could be achieved by permitting all taxpayers that make the CRE and the ARE to apply the Earnings and Capital Method.

Even though the Earnings and Capital Method aligns with financial accounting rules, Treasury and the IRS expressed concern that the method permitted the selective recognition of section 987 gains or losses (including on assets that were not subject to currency fluctuations) through remittances or branch terminations. As a result of these concerns, Treasury and the IRS ultimately proposed a new method, the FEEP method, reflected in the 2006 Proposed Regulations[1] and the 2016 Final Regulations.

The FEEP method introduced an income identification mechanism whereby assets or liabilities that are subject to currency fluctuations are translated in the owner's functional currency at year-end spot rate (i.e., the average exchange rate for the taxable year), and historic assets that are not subject to currency changes are translated at historic rates. The FEEP method was introduced to prevent the selective recognition of section 987 losses on assets that were not subject to currency fluctuations. This method reflects a deviation from financial accounting rules. Treasury and the IRS have conceded that the diverging exchange rate translation mechanisms created varying balance sheet values for taxpayers, arising from fluctuating exchange rates on marked income items, while historic assets remained constant.[2] Further, Treasury and the IRS acknowledge that the FEEP method has been criticized as being overly complex, primarily in its treatment of historic items as opposed to marked items, resulting in taxpayers being forced to maintain separate books and records for marked and historic items in order to ensure accuracy.[3] In comparison to the FEEP Method, the Earnings and Capital Method is relatively easy to administer as it is aligned with financial accounting.

The 2023 Proposed Regulations introduced the CRE and ARE in response to the policy mandate[4] to mitigate administrative burdens and introduce compliance simplification methods to the 2016 Final Regulations. Treasury and the IRS noted that the simplifying elections within the 2023 Proposed Regulations were drafted in order to "more closely conform to the financial accounting rules."[5] Together, these elections provide adequate safeguards to prevent the types of selective recognition of section 987

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[1] *See* Preamble to the 2006 Proposed Regulations, 71 Fed. Reg. 52876, 52879 (Sept. 7, 2006).
[2] Preamble to the 2023 Proposed Regulations, 88 Fed. Reg. 78134, 78138 (Nov. 14, 2023).
[3] *Id.*
[4] *See* Second Report to the President on Identifying and Reducing Regulatory Tax Burdens, 82 Fed. Reg. 48013 (Oct. 16, 2017); Preamble to the 2023 Proposed Regulations, 88 Fed. Reg. 78134.
[5] *Id.*

gains or losses that motivated Treasury and the IRS to depart from the Earnings and Capital Method. Permitting taxpayers that elect the CRE and the ARE to continue to use the Earnings and Capital Method will reduce compliance burden while adequately protecting the fisc.

Under the CRE, all items of income, gain, deduction, and loss would be translated at the yearly average exchange rate for the current taxable year for the purposes of calculating section 987 taxable income. In addition, assets and liabilities would be translated at the year-end spot rate for the purposes of computing section 987 gain or loss. The CRE is intended to produce results for current-year items that are similar to those under the Earnings and Capital Method, which conform to financial reporting rules. While loss suspension rules generally apply, taxpayers electing the ARE generally are not subject to these rules because such taxpayers are required to recognize all net unrecognized section 987 gains or losses on an annual basis. Ultimately, the proposed rules seem intended to provide taxpayers electing both the CRE and the ARE with results that are generally consistent with the Earnings and Capital Method plus the annual recognition of all unrecognized gains or losses, thereby preventing the selective recognition of gains and losses that caused Treasury and the IRS to reconsider the Earnings and Capital Method. Accordingly, we recommend that the regulations permit taxpayers that have been applying the Earnings and Capital Method continue to apply this method so long as the taxpayers elect the CRE and the ARE.

Section 988 in a section 987 QBU Election

NFTC suggests Treasury provide an election for section 988 at the section 987 QBU, as a corollary to the regulations in §1.988-7. This would provide a section 988 mark-to-market election within a section 987 QBU. The section 987 mark-to-market elections should use section 988 as the measure of the gains or losses in the section 987 QBU.

While we understand that the mark-to-market election (e.g., the ARE) is expressly for section 987 purposes, we request an approach to also mark section 988 positions within section 987 QBUs, as detailed below.

In particular, the §1.988-7 mark to market election for section 988 applies at the regarded entity level and does not apply at the section 987 QBU level. This poses a unique challenge where offsetting nonfunctional currency positions might be in a section 987 QBU, but the resulting section 988 gain or loss is at the level of the section 987 QBU's parent. Accordingly, a question as to how to manage section 1092 implications is not addressed by the ARE election, if adopted, as the election is expressly for section 987 purposes, as noted.

We would either like confirmation that the ARE election would also apply for nonfunctional currency positions held at the QBU level or otherwise provide a separate mark-to-market election for section 988 at the section 987 QBU level, or otherwise extension of §1.988-7 election, or by Treasury providing a new election. That is, by allowing marking to market of section 988 positions in a section 987 QBU through one of the proposed options, both legs in an offsetting position held at the section 987 QBU would be recognized for section 988 purposes and would not be subject to the section 1092 straddle rules. This would address a gap in the guidance where inclusions are at the parent and positions are held at the subsidiary and where an ARE election is made would otherwise prevent any potential abuse or selective loss triggering by compelling the recognition of all unrealized gain and loss at the branch and disregarded entity level.

Off-set of gain or loss

The Proposed Regulations clarify the treatment of section 987 gains and losses with regard to Subpart F, GILTI and other provisions in §1.987-6. Specifically, in §1.987-6(b)(2)(i)(C) treatment of section 987 gains or losses assigned to Subpart F income is detailed in section 954(c)(1)(D). To the extent the section 987 gains or losses are characterized as section 988 by application of §1.987-6 in sourcing to assets that generate the separate category of these section 988 gains or losses, we request Treasury clarify that all provisions relevant to such gains or losses apply (e.g., availability of election under §1.954-2(g)(4)).

For example, a CFC's QBU generates significant section 987 gains treated as section 988 foreign personal holding company income ("FPHCI") under section 954(c)(1)(d) at the CFC. However, where the CFC has other section 988 losses, the CFC will have a section 988 inclusion of the gain (for the portion stemming from the QBU) as well as a potential loss resulting from a "non-qualified deficit" (for the portion of the section 988 loss stemming directly from the CFC), for an unduly punitive impact on taxpayers.

We further request Treasury to provide regarded taxpayers an election or expanded application of existing elections such as §1.954-2(g)(4), to allow section 987 gains and losses that are assigned to Subpart F income as under section 954(c)(1)(D), to offset other passive gains and losses of a CFC. Allowing such an election more closely aligns with the underlying economic reality that occurs when a taxpayer has section 987 gain or loss treated as section 988 gain or loss. As an example, if a section 987 QBU were to make an election to be treated as a corporation under §301.7701-3(c), the entity would be able to make further elections to allow the section 988 loss to offset other types of income, when the requirements of such elections are met. Additional detail is provided below regarding losses in a section 987 QBU treated as section 988 loss at the CFC.

The Proposed Regulations do not address the authority to include section 987 gains or losses that are sourced to assets producing Subpart F gains or losses pursuant to section 954(c)(1)(D), as the statute only expressly addresses section 988. We request clarification on the authority which allows the application of this rule to section 987, which seemingly expands beyond the section 988 statute.

Suspended losses

NFTC questions the treatment of permanently suspended losses when a CFC with section 987 losses terminates in the U.S. under §1.987-13(g). The Proposed Regulations utilize the loss suspension rules based on concerns about potential abuses and inappropriate outcomes from taxpayers choosing to trigger section 987 losses while avoiding or deferring section 987 gains. However, it is unclear why the Treasury views inbound losses from terminating QBUs (i.e., losses included in the US parent) to be permanently suspended in §1.987-13(g) in the same manner.

This unique treatment to permanently suspend losses neither fits with the broader framework set forth in the proposed §1.987-11 loss-to-the extent-of-gain rule nor acknowledges that taxpayers adopting the ARE would be making the election in part to evidence that there is not a plan to trigger losses without gains, and ignores that there may be terminations as part of restructurings that are not at all tax motivated and where foreign exchange impacts could result in a tax benefit or detriment.

NFTC proposes Treasury either: (1) remove the permanent inbound loss suspension or otherwise replace it with a principal purpose test, which is consistent with other parts of the regulations where there are concerns about potential abuses; (2) replace the permanent inbound loss suspension rule with a rule to limit the usage inbound section 987 losses to offset inbound section 987 gains of the same owner in the same residual category (i.e., loss to the extent of gain, as discussed below); (3) capitalize the losses as an intangible asset of the US entity and allow them to be used ratably over a ten year period, in line with the other capitalization provision in the 2023 section 987 proposed regulations; or (4) preserve the benefit of the loss as a step-up in the tax basis the US shareholder for future benefit upon potential disposition of the US entity.

Expansion of the Loss-to-the-Extent-of-Gain Rule

Under the Proposed Regulations in §1.987-11(e), an owner of a section 987 QBU would only recognize a suspended section 987 loss in a taxable year when the owner recognizes section 987 gain in a recognition grouping that has the same source and character as the suspended section 987 loss. While the Proposed Regulations allow this loss-to-the-extent-of-gain recognition from separate QBUs of the same regarded parent, the Proposed Regulations do not make clear if the offset to income at the regarded parent is allowed to the extent that the loss is characterized as an item that could offset other income at the regarded parent.

For example, a CFC owner of QBU 1 with a suspended loss of 100 generated by QBU 1 and characterized as foreign source and general category-tested loss after application of Proposed Regulation in §1.987-6(b) should be able to recognize that 100 loss to the extent that it has at least 100 of foreign source general category tested income from other transactions, even if such income is not initially from section 987 gain.

In the absence of allowing this treatment, taxpayers would be whipsawed into a gain, but not loss recognition for transactions that are otherwise economically similar. Accordingly, we request for Treasury and the IRS to expand the loss-to the extent-of-gain-rule in the Proposed Regulation §1.987-11(e) so that a suspended section 987 loss may be recognized to the extent of the owner's taxable gain (not just section 987 gain) that has the same source and character as the suspended section 987 loss. In addition, Treasury and the IRS should consider providing taxpayers with the ability to carry back the loss to address timing differences.

This comment is consistent with the separate comment above and relevant in an inverse case:
For example, a CFC with significant section 987 losses is treated as section 988 FPHCI loss under section 954(c)(1)(d) at the CFC, but where the CFC has other section 988 gains. In this instance, the CFC would have a section 988 inclusion of the gain (for the portion stemming from the CFC) as well as a potential lost loss for a 'non-qualified deficit' (for the portion of the section 988 loss stemming from the section 987 QBU), for an unduly punitive impact on taxpayers.

Further, while a CFC is able to make a §1.954-2(g)(4) election to treat its foreign currency exchange gain or loss as interest, the regulations as currently drafted do not make clear if such an election would apply to section 988 losses treated at the CFC stemming from that CFC's section 987 QBU. To that end, another example would be if a CFC has no section 988 losses other than section 987 losses treated as section 988 FPHCI losses at the CFC level but has a significant amount of interest treated as FPHCI. Without additional guidance, it is unclear whether the CFC can make a §1.954-2(g)(4) election to treat FPHCI currency losses as non-currency FPHCI, such that the section 987 losses, if treated as section 988 at the CFC should be treated as section 988 for all purposes.

We request Treasury provide guidance that section 987 gains or losses treated as section 988 at the CFC level are treated for all purposes as section 988 gains or losses, unless specifically noted otherwise. This should include the application of elections, such as for the §1.954-2(g)(4) election, to avoid unduly punitive results such as lost 'non-qualified deficits.'

Incremental Tax Forms and Compliance

International Tax Reporting has expanded and significantly changed in the last decade. Previously, most Forms 5471, Information Return of U.S. Persons with Respect To Certain Foreign Corporations, were about 15 pages in length. As new guidance was issued under TCJA, the IRA, and other recent legislation, the IRS expanded the forms to take into account the new requirements. Thus, in recent years, the length has jumped to approximately 60 pages and can reach over 100 pages. This has created significant burdens on taxpayers with entities and/or operations overseas. The proposed section 987 regulation suggests that additional new compliance obligations will be created, which will further complicate an already complex and burdensome system.

Further to the comments above allowing taxpayers to follow the proposed 1991 regulations, we propose that no incremental tax forms or reporting be required for Taxpayers who make the CRE election.

For taxpayers who do not make the CRE election, we would suggest that the reporting for section 987 reporting remain on Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs), Schedule C-1. Schedule C-1 could be slightly modified to account for the transition to the FEEP method providing the IRS summary information which they can use to assess risk under an audit.

For example, Schedule C-1 could contain:

- Tax basis in marked items BOY and EOY
- Tax basis in historic items BOY and EOY
- Transfers to the QBU during the year
- Transfers from the QBU during the year
- Amount of currency gain or loss
- Amount (if any) of suspended losses.

We believe this level of information will allow the IRS to manage audit risk without expanding the tax reporting requirements on a separate tax form. To the extent this simplification is not feasible, we nevertheless request simplified reporting for taxpayers that make the CRE, ARE, or both elections. These elections are intended to simplify the calculation and the reporting for these taxpayers should likewise be simplified.

Finally, if new forms are required to comply with the proposed regulations, the forms should be shared with taxpayers a minimum of six months in advance of the start of the tax year for which the reporting will apply. We also request that these be included in the IRS e-file system as opposed to creating a separate PDF form.

Conclusion

We appreciate the continued dialogue with the business community on this complex issue and thank you for your consideration of our comments. Please reach out to Anne Gordon, Vice President for International Tax Policy, with any questions or for additional information on these comments.