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(C) *Total loss on remittance.* The total combined loss on the remittance is ≤\$5,200>. The total of amounts determined in paragraphs (ii)(A) and (B) of this Example 1.

Example 2: (i) *Facts.* D is a domestic corporation. B, a QBU branch of D, operates in country X. B's functional currency is the FC. At the end of B's last taxable year beginning before October 25, 1991, B's EQ pool equals 15,000 FC and B's post-86 profits pool equals

8,000 FC. B's \$E amount equals \$9,000, and the \$P pool equals \$1,000. In B's first taxable year beginning on or after October 25, 1991, B remits 18,000 FC. Under section 987, the appropriate exchange rate for this remittance is 10FC:\$1.

- (ii) *Computation of the equity pool.*
15,000 FC (EQ pool) + 8,000 FC (post-86 profits pool) = 23,000 FC (equity pool)
- (iii) *Computation of the basis pool.*

$$\$9,000 (\$E \text{ amount}) + \$1,000 (\$P \text{ amount}) = \$10,000$$

(iv) *Dollar basis in remittance.*

$$\frac{18,000 \text{ FC (amount of remittance)}}{23,000 \text{ FC (equity pool)}} \times \$10,000 = \$7,826$$

(v) *Computation of section 987 loss by U.S. on remittance.*

$$\$1,800 (\text{dollar value of remittance}) - \$7,826 (\text{dollar basis in remittance}) = \text{< } \$6,026 \text{ >} \\ (\text{loss on remittance})$$

(h) *Character and source of section 987 gain or loss.* Section 987 gain or loss is sourced and characterized as provided by section 987 and regulations issued under that section.

[T.D. 8367, 56 FR 48434, Sept. 25, 1991; 56 FR 65684, Dec. 18, 1991]

§ 1.988-0 Taxation of gain or loss from a section 988 transaction; Table of Contents.

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 - (2) Computation of exchange gain or loss.
 - (b) Translation of interest income or expense and determination of exchange gain or loss with respect to debt instruments.
 - (1) Translation of interest income received with respect to a nonfunctional currency demand account.

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(3) Exchange gain or loss recognized by the holder with respect to accrued interest income.

(4) Exchange gain or loss recognized by the obligor with respect to accrued interest expense.

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(1) In general.

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(3) Requirements for making the election.

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(c) Exchange gain or loss treated as interest.

(1) In general.

(2) Exchange loss realized by the holder on nonfunctional currency tax exempt bonds.

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§ 1.988-4 Source of gain or loss realized on a section 988 transaction.

(a) In general.

(b) Qualified business unit.

(1) In general.

(2) Proper reflection on the books of the taxpayer or qualified business unit.

(c) Effectively connected exchange gain or loss.

(d) Residence.

(1) In general.

(2) Exception.

(3) Partner in a partnership not engaged in a U.S. trade or business under section 864(b)(2).

(e) Special rule for certain related party loans.

(1) In general.

(2) United States person.

(3) Loans by related person.

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(g) Exchange gain or loss allocated in the same manner as interest under § 1.861-9T.

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§ 1.988-5 Section 988(d) hedging transactions.

(a) Integration of a nonfunctional currency debt instrument and a § 1.988-5(a) hedge.

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(2) Exception.

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(4) Section 1.988-5(a) hedge.

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(9) Taxation of qualified hedging transactions.

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(2) Definitions.

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(c) Hedges of period between trade date and settlement date on purchase or sale of publicly traded stock or security.

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(f) [Reserved]

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§ 1.988-6 *Nonfunctional Currency Contingent Payment Debt Instruments*

(a) In general.

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(2) Exception for hyperinflationary currencies.

(b) Instruments described in paragraph (a)(1)(i) of this section.

(1) In general.

(2) Application of noncontingent bond method.

(3) Treatment and translation of amounts determined under noncontingent bond method.

(4) Determination of gain or loss not attributable to foreign currency.

(5) Determination of foreign currency gain or loss.

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(c) Examples.

(d) Multicurrency debt instruments.

(1) In general.

(2) Determination of denomination currency.

(3) Issuer/holder consistency.

(4) Treatment of payments in currencies other than the denomination currency.

(e) Instruments issued for nonpublicly traded property.

(1) Applicability.

(2) Separation into components.

(3) Treatment of components consisting of one or more noncontingent payments in the same currency.

(4) Treatment of components consisting of contingent payments.

(5) Basis different from adjusted issue price.

(6) Treatment of holder on sale, exchange, or retirement.

(f) Rules for nonfunctional currency tax exempt obligations described in § 1.1275-4(d).

(g) Effective date.

[T.D. 8400, 57 FR 9177, Mar. 17, 1992, as amended by T.D. 8860, 65 FR 2028, Jan. 13, 2000; T.D. 9157, 69 FR 52818, Aug. 30, 2004]

§ 1.988-1 **Certain definitions and special rules.**

(a) *Section 988 transaction*—(1) *In general.* The term “section 988 transaction” means any of the following transactions—

(i) A disposition of nonfunctional currency as defined in paragraph (c) of this section;

(ii) Any transaction described in paragraph (a)(2) of this section if any amount which the taxpayer is entitled to receive or is required to pay by reason of such transaction is denominated in terms of a nonfunctional currency or is determined by reference to the value of one or more nonfunctional currencies.

A transaction described in this paragraph (a) need not require or permit payment with a nonfunctional currency as long as any amount paid or received is determined by reference to the value of one or more nonfunctional currencies. The acquisition of nonfunctional currency is treated as a section 988 transaction for purposes of establishing the taxpayer's basis in such currency and determining exchange gain or loss thereon.

(2) *Description of transactions.* The following transactions are described in this paragraph (a)(2).

(i) *Debt instruments.* Acquiring a debt instrument or becoming an obligor under a debt instrument. The term “debt instrument” means a bond, debenture, note, certificate or other evidence of indebtedness.

(ii) *Payables, receivables, etc.* Accruing, or otherwise taking into account, for purposes of subtitle A of the Internal Revenue Code, any item of expense or gross income or receipts which is to be paid or received after the date on which so accrued or taken into account. A payable relating to cost of goods sold, or a payable or receivable relating to a capital expenditure or receipt, is within the meaning of this paragraph (a)(2)(ii). Generally, a payable relating to foreign taxes (whether or not claimed as a credit under section 901) is within the meaning of this