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§§ 1.987–5 and 1.987–8 for the consequences of a termination of a section 987 QBU that is subject to §§ 1.987–1 through 1.987–11.

(f) *Example.* The provisions of this section are illustrated by the following example:

Example. (i) *Facts.* FC, a foreign corporation, owns all of the stock of DC, a domestic corporation. The Commissioner granted permission to change FC's functional currency from the British pound to the euro beginning January 1, 2020. The EUR/GBP exchange rate on December 31, 2019, is €1:£0.50.

(ii) *Determining new functional currency basis of property and liabilities.* The following table shows how FC must convert the items on its balance sheet from the British pound to the euro on December 31, 2019.

	GBP	EUR
Assets:		
Cash on hand	£40,000	€80,000
Accounts Receivable	10,000	20,000
Inventory	100,000	200,000
€100,000 Euro Bond (£100,000 historical basis)	50,000	100,000
Fixed assets:		
Property	200,000	400,000
Plant	500,000	1,000,000
Accumulated Depreciation	(200,000)	(400,000)
Equipment	1,000,000	2,000,000
Accumulated Depreciation	(400,000)	(800,000)
Total Assets	1,300,000	2,600,000
Liabilities:		
Accounts Payable	50,000	100,000
Long-term Liabilities	400,000	800,000
Paid-in-Capital	800,000	1,600,000
Retained Earnings	50,000	100,000
Total Liabilities and Equity	1,300,000	2,600,000

(iii) *Exchange gain or loss on section 988 transactions.* Under paragraph (b) of this section, FC will recognize a £50,000 loss (£50,000 current value minus £100,000 historical basis) on the Euro Bond resulting from the change in functional currency because, after the change, the Euro Bond will no longer be an asset denominated in a non-functional currency. The amount of FC's retained earnings on its December 31, 2019, balance sheet reflects the £50,000 loss on the Euro Bond.

(g) *Effective/applicability date.* Generally, this regulation shall apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. If pursuant to § 1.987–11(b) a taxpayer applies §§ 1.987–1 through 1.987–11 beginning in a taxable year prior to the earliest taxable year described in § 1.987–11(a), then this section shall apply to taxable years of the taxpayer beginning on or after the first day of such prior taxable year.

[T.D. 9794, 81 FR 88819, Dec. 8, 2016]

§ 1.985–6 Transition rules for a QBU that uses the dollar approximate separate transactions method for its first taxable year beginning in 1987.

(a) *In general.* This section sets forth transition rules for a QBU that used the dollar approximate separate transactions method of accounting set forth in § 1.985–3 or § 1.985–3T (as contained in the April 1, 1989 edition of 26 CFR part 1 (1.908 to 1.1000)) for its first taxable year beginning in 1987 (DASTM QBU). A DASTM QBU must determine the dollar and hyperinflationary currency basis of its assets and the dollar and hyperinflationary currency amount of its liabilities that were acquired or incurred in taxable years beginning before January 1, 1987. In addition, a DASTM QBU must determine its net worth, including its retained earnings, at the end of the QBU's last taxable year beginning before January 1, 1987. This section provides rules for controlled foreign corporations (as defined in section 957 or section 953(c)(1)(B)), other foreign corporations, and

branches of United States persons that must make these determinations.

(b) *Certain controlled foreign corporations.* If a DASTM QBU was a controlled foreign corporation for its last taxable year beginning before January 1, 1987, and it had a significant event as described in §1.964–1(c)(6) in a taxable year beginning before January 1, 1987, then the rules of this paragraph (b) shall apply.

(1) *Basis in assets and amount of liabilities.* The hyperinflationary currency adjusted basis of the QBU's assets and the hyperinflationary currency amount of the QBU's liabilities acquired or incurred by the QBU in a taxable year beginning before January 1, 1987, shall be the basis or the amount as determined under §1.964–1(e) prior to translation under §1.964–1(e)(4). The dollar adjusted basis of such assets and the dollar amount of such liabilities shall be the adjusted basis or the amount as determined under the rules of §1.964–1(e) after translation under §1.964–1(e)(4).

(2) *Retained earnings.* The dollar amount of the QBU's retained earnings at the end of its last taxable year beginning before January 1, 1987, shall be the dollar amount determined under §1.964–1(e)(3).

(c) *All other foreign corporations.* If a foreign corporation is a DASTM QBU that is not described in paragraph (b) of this section, then the hyperinflationary currency and dollar adjusted basis in the QBU's assets acquired in taxable years beginning before January 1, 1987, the hyperinflationary currency and dollar amount of the QBU's liabilities acquired or incurred in taxable years beginning before January 1, 1987, and the dollar amount of the QBU's net worth, including its retained earnings, at the end of its last taxable year beginning before January 1, 1987, shall be determined by applying the principles of §1.985–3T or §1.985–3. Thus, for example, the dollar basis of plant and equipment shall be determined using the appropriate historical exchange rate.

(d) *Pre-1987 section 902 amounts*—(1) *Translation of pre-1987 section 902 accumulated profits and taxes into United States dollars.* The foreign income taxes and accumulated profits or deficits in accumulated profits of a foreign corporation that were maintained in foreign currency for purposes of section 902 and that are attributable to taxable years of the foreign corporation beginning before January 1, 1987, shall be translated into dollars at the spot exchange rate on the first day of its first taxable year beginning after December 31, 1986. Once translated into dollars, these accumulated profits and taxes shall (absent a change in functional currency) remain in dollars for all federal income tax purposes.

(2) *Carryforward of accumulated deficits in accumulated profits from pre-1987 taxable years to post-1986 taxable years.* For purposes of sections 902 and 960, the post-1986 undistributed earnings of a foreign corporation that is subject to the rules of this section shall be reduced by the dollar amount of the corporation's deficit in accumulated profits, if any, determined under section 902 and the regulations thereunder, that was accumulated at the end of the corporation's last taxable year beginning before January 1, 1987. The dollar amount of the accumulated deficit shall be determined by multiplying the foreign currency amount of such deficit by the spot exchange rate on the last day of the corporation's last taxable year beginning before January 1, 1987, and shall be taken into account on the first day of the corporation's first taxable year beginning after December 31, 1986. Post-1986 undistributed earnings may not be reduced by the dollar amount of a pre-1987 deficit in retained earnings determined under §1.964–1(e).

(e) *Net worth branch.* If a DASTM QBU is a branch of a United States person and the QBU used a net worth method of accounting for its last taxable year beginning before January 1, 1987, then the rules of this paragraph (e) shall apply. A net worth method of accounting is any method of accounting under which the taxpayer calculates the taxable income of a QBU based on the net change in the dollar value of the QBU's equity (assets minus liabilities) during the course of a taxable year, taking into account any contributions or remittances made during the year. See, *e.g.*, Rev. Rul. 75–106, 1975–1 C.B. 31. (See §601.601(d)(2)(ii)(*b*) of this chapter).

(1) *Basis in assets and amount of liabilities*—(i) *Hyperinflationary amounts.* For the first taxable year beginning in 1987, the hyperinflationary currency adjusted basis of a QBU's assets or the hyperinflationary currency amounts of its liabilities acquired or incurred in a taxable year beginning before January 1, 1987 is the hyperinflationary currency basis or amount at the date when acquired or incurred, as adjusted according to United States generally accepted accounting and tax accounting principles. If a hyperinflationary currency basis or amount was not determined at such date, the dollar basis or amount, as adjusted according to United States generally accepted accounting and tax accounting principles, shall be translated into hyperinflationary currency at the spot exchange rate on the date when the asset or liability was acquired or incurred.

(ii) *Dollar amounts.* For the first taxable year beginning in 1987, the dollar adjusted basis of the QBU's assets and the amounts of its liabilities shall be those amounts reflected on the QBU's dollar books and records at the end of the taxpayer's last taxable year beginning before January 1, 1987, after adjusting the books and records according to United States generally accepted accounting and tax accounting principles.

(2) *Ending net worth.* The dollar amount of the QBU's net worth at the end of its last taxable year beginning before January 1, 1987 shall equal the QBU's net worth at that date as determined under paragraph (e)(1)(ii) of this section.

(f) *Profit and loss branch.* If a DASTM QBU is a branch of a United States person and the QBU used a profit and loss method of accounting for its last taxable year beginning before January 1, 1987, then the United States person shall first apply the transition rules of §1.987–5 in order to determine the beginning amount and dollar basis of the branch's EQ pool, the hyperinflationary currency basis of the branch's assets, and the hyperinflationary currency amounts of its liabilities. A profit and loss method of accounting is any method of accounting under which the taxpayer calculates the profits of a QBU by computing the QBU's profits in its functional currency and translating the net result into dollars. See *e.g.*, Rev. Rul. 75–107, 1975–1 C.B. 32. (See §601.601(d)(2)(ii)(*b*) of this chapter). The QBU and the taxpayer must then make the adjustments required by §1.985–5, *e.g.*, the QBU must take into account unrealized exchange gain or loss on dollar-denominated section 988 transactions, the taxpayer must account for the deemed termination of the branch, and the taxpayer must translate the QBU's balance sheet items from hyperinflationary currency into dollars at the spot rate.

[T.D. 8464, 58 FR 234, Jan. 5, 1993]

§1.985–7 Adjustments required in connection with a change to DASTM.

(a) *In general.* If a QBU begins to use the dollar approximate separate transactions method of accounting set forth in §1.985–3 (DASTM) in a taxable year beginning after April 6, 1998, adjustments shall be made as provided by this section. For the rules with respect to foreign corporations, see paragraph (b) of this section. For the rules with respect to adjustments to the income of United States shareholders of controlled foreign corporations, see paragraph (c) of this section. For the rules with respect to adjustments relating to QBU branches, see paragraph (d) of this section. For the effective date of this section, see paragraph (e). For purposes of applying this section, the look-back period shall be the period beginning with the first taxable year after the transition date and ending on the last day prior to the taxable year of change. The term transition date means the later of the last day of the last taxable year ending before the base period as defined in §1.985–1(b)(2)(ii)(D) or the last day of the taxable year in which the QBU last applied DASTM. The taxable year of change shall mean the taxable year of change as defined in §1.481–1(a)(1). The application of this paragraph may be illustrated by the following examples:

Example 1. A calendar year QBU that has not previously used DASTM operates in a country in which the functional currency of the country is hyperinflationary as defined under §1.985–1(b)(2)(ii)(D) for the QBU's 1999