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1(c)(3)) are translated pursuant to paragraph (c)(2) of this section at the same historic rates as were used under the taxpayer's application of the 2006 proposed regulations or at the historic rates determined under §1.987–1(c)(3).

(iv) With respect to each section 987 QBU with respect to which an adjustment is made pursuant to paragraph (d) of this section, a description of the adjustment and the basis for the computation of such adjustments.

(2) *Attachments not required where information is reported on a form.* Paragraph (e) of this section shall not apply to the extent the information described in such paragraph is required to be reported on a form published by the Commissioner.

[T.D. 9794, 81 FR 88845, Dec. 8, 2016]

§1.987–11 Effective/applicability date.

(a) *In general.* Except as otherwise provided in this section, §§1.987–1 through 1.987–10 shall apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016.

(b) *Application of these regulations to taxable years beginning after* December 7, 2016. A taxpayer may apply these regulations under section 987 to taxable years beginning after December 7, 2016, provided the taxpayer consistently applies these regulations to such taxable years with respect to all section 987 QBUs directly or indirectly owned by the taxpayer on the transition date (as defined in paragraph (b)(2) of this section) as well as all section 987 QBUs directly or indirectly owned on the transition date by members that file a consolidated return with the taxpayer or by any controlled foreign corporation, as defined in section 957, in which a member owns more than 50 percent of the voting power or stock value, as determined under section 958(a).

(c) *Transition date.* The transition date is the first day of the first taxable year to which these regulations under section 987 are applicable with respect to a taxpayer under this section.

[T.D. 9794, 81 FR 88845, Dec. 8, 2016]

§1.987–12 Deferral of section 987 gain or loss.

(a) through (h) [Reserved]. For further guidance, see §1.987–12T(a) through (h).

[T.D. 9795, 81 FR 88875, Dec. 8, 2016]

§1.987–12T Deferral of section 987 gain or loss (temporary).

(a) *In general*—(1) *Overview.* This section provides rules that defer the recognition of section 987 gain or loss that, but for this section, would be recognized in connection with certain QBU terminations and certain other transactions involving partnerships. This paragraph (a) provides an overview of this section and describes the section's scope of application, including with respect to QBUs subject to section 987 but to which §§1.987–1 through 1.987–11 generally do not apply. Paragraph (b) of this section describes the extent to which section 987 gain or loss is recognized under §1.987–5 or similar principles in the taxable year of a deferral event (as defined in paragraph (b)(2) of this section) with respect to a QBU. Paragraph (c) of this section describes the extent to which section 987 gain or loss that, as a result of paragraph (b), is not recognized under §1.987–5 or similar principles is recognized upon the occurrence of subsequent events. Paragraph (d) of this section describes the extent to which section 987 loss is recognized under §1.987–5 or similar principles in the taxable year of an outbound loss event (as defined in paragraph (d)(2) of this section) with respect to a QBU. Paragraph (e) of this section provides rules for determining the source and character of gains and losses that, as a result of this section, are not recognized under §1.987–5 or similar principles in the taxable year of a deferral event or outbound loss event. Paragraph (f) of this section defines controlled group and qualified successor for purposes of this section. Paragraph (g) of this section provides an anti-abuse rule. Paragraph (h) of this section provides examples illustrating the rules described in this section.

(2) *Scope.* This section applies to any foreign currency gain or loss realized under section 987(3), including foreign

currency gain or loss of an entity described in §1.987–1(b)(1)(ii). References in this section to section 987 gain or loss refer to any foreign currency gain or loss realized under section 987(3), references to a section 987 QBU refer to any eligible QBU (as defined in §1.987–1(b)(3)(i), but without regard to §1.987–1(b)(3)(ii)) that is subject to section 987, and references to a section 987 aggregate partnership refer to any partnership for which the acquisition or disposition of a partnership interest could give rise to foreign currency gain or loss realized under section 987(3). Additionally, references to recognition of section 987 gain or loss under §1.987–5 encompass any determination and recognition of gain or loss under section 987(3) that would occur but for this section. Accordingly, the principles of this section apply to a QBU subject to section 987 regardless of whether the QBU otherwise is subject to §§1.987–1 through 1.987–11. An owner of a QBU that is not subject to §1.987–5 must adapt the rules set forth in this section as necessary to recognize section 987 gains or losses that are subject to this section consistent with the principles of this section.

(3) *Exceptions*—(i) *Annual deemed termination elections.* This section does not apply to section 987 gain or loss of a section 987 QBU with respect to which the annual deemed termination election described in §1.987–8T(d) is in effect.

(ii) *De minimis exception.* This section does not apply to a section 987 QBU for a taxable year if the net unrecognized section 987 gain or loss of the section 987 QBU that, as a result of this section, would not be recognized under §1.987–5 in the taxable year does not exceed $5 million.

(b) *Gain and loss recognition in connection with a deferral event*—(1) *In general.* Notwithstanding §1.987–5, the owner of a section 987 QBU with respect to which a deferral event occurs (a deferral QBU) includes in taxable income section 987 gain or loss in connection with the deferral event only to the extent provided in paragraphs (b)(3) and (c) of this section. However, if the deferral event also constitutes an outbound loss event described in paragraph (d) of this section, the amount of loss recognized by the owner may be further limited under that paragraph.

(2) *Deferral event*—(i) *In general.* A deferral event with respect to a section 987 QBU means any transaction or series of transactions that satisfy the conditions described in paragraphs (b)(2)(ii) and (b)(2)(iii) of this section.

(ii) *Transactions.* The transaction or series of transactions include either:

(A) A termination of the section 987 QBU other than any of the following terminations: a termination described in §1.987–8(b)(3), a termination described in §1.987–8(c), or a termination described solely in §1.987–8(b)(1); or

(B) A disposition of part of an interest in a section 987 aggregate partnership or DE through which the section 987 QBU is owned or any contribution by another person to such a partnership or DE of assets that, immediately after the contribution, are not considered to be included on the books and records of an eligible QBU, provided that the contribution gives rise to a deemed transfer from the section 987 QBU to the owner.

(iii) *Assets on books of successor QBU.* Immediately after the transaction or series of transactions, assets of the section 987 QBU are reflected on the books and records of a successor QBU (as defined in paragraph (b)(4) of this section).

(3) *Gain or loss recognized under §1.987–5 in the taxable year of a deferral event.* In the taxable year of a deferral event with respect to a deferral QBU, the owner of the deferral QBU recognizes section 987 gain or loss as determined under §1.987–5, except that, solely for purposes of applying §1.987–5, all assets and liabilities of the deferral QBU that, immediately after the deferral event, are reflected on the books and records of a successor QBU are treated as not having been transferred and therefore as remaining on the books and records of the deferral QBU notwithstanding the deferral event.

(4) *Successor QBU.* For purposes of this section, a section 987 QBU (potential successor QBU) is a successor QBU with respect to a section 987 QBU referred to in paragraph (b)(2)(ii) of this

section if, immediately after the transaction or series of transactions described in that paragraph, the potential successor QBU satisfies all of the conditions described in paragraphs (b)(4)(i) through (b)(4)(iii) of this section.

(i) The books and records of the potential successor QBU reflect assets that, immediately before the transaction or series of transactions described in paragraph (b)(2)(ii) of this section, were reflected on the books and records of the section 987 QBU referred to in that paragraph.

(ii) The owner of the potential successor QBU and the owner of the section 987 QBU referred to in paragraph (b)(2)(ii) of this section immediately before the transaction or series of transactions described in that paragraph are members of the same controlled group.

(iii) In the case of a section 987 QBU referred to in paragraph (b)(2)(ii)(A) of this section, if the owner of the section 987 QBU immediately before the transaction or series of transactions described in that paragraph was a U.S. person, the potential successor QBU is owned by a U.S. person.

(c) *Recognition of deferred section 987 gain or loss in the taxable year of a deferral event and in subsequent taxable years*—(1) *In general*—(i) *Deferred section 987 gain or loss.* A deferral QBU owner (as defined in paragraph (c)(1)(ii) of this section) recognizes section 987 gain or loss attributable to the deferral QBU that, as a result of paragraph (b) of this section, is not recognized in the taxable year of the deferral event under §1.987–5 (deferred section 987 gain or loss) in the taxable year of the deferral event and in subsequent taxable years as provided in paragraphs (c)(2) through (4) of this section.

(ii) *Deferral QBU owner.* For purposes of this paragraph (c), a deferral QBU owner means, with respect to a deferral QBU, the owner of the deferral QBU immediately before the deferral event, or the owner's qualified successor.

(2) *Recognition upon a subsequent remittance*—(i) *In general.* Except as provided in paragraph (c)(3) of this section, a deferral QBU owner recognizes deferred section 987 gain or loss in the taxable year of the deferral event and in subsequent taxable years upon a remittance from a successor QBU to the owner of the successor QBU (successor QBU owner) in the amount described in paragraph (c)(2)(ii) of this section.

(ii) *Amount.* The amount of deferred section 987 gain or loss that is recognized pursuant to this paragraph (c)(2) in a taxable year of the deferral QBU owner is the outstanding deferred section 987 gain or loss (that is, the amount of deferred section 987 gain or loss not previously recognized) multiplied by the remittance proportion of the successor QBU owner with respect to the successor QBU for the taxable year ending with or within the taxable year of the deferral QBU owner, as determined under §1.987–5(b) (and, to the extent relevant, paragraphs (b) and (c)(2)(iii) of this section) without regard to any election under §1.987–8T(d). For purposes of computing this remittance proportion, multiple successor QBUs of the same deferral QBU are treated as a single successor QBU.

(iii) *Deemed remittance when a successor QBU ceases to be owned by a member of the deferral QBU owner's controlled group.* For purposes of this paragraph (c)(2), in a taxable year of the deferral QBU owner in which a successor QBU ceases to be owned by a member of a controlled group that includes the deferral QBU owner, the successor QBU owner is treated as having a remittance proportion of 1. Accordingly, if there is only one successor QBU with respect to a deferral QBU and that successor QBU ceases to be owned by a member of the controlled group that includes the deferral QBU owner, all outstanding deferred section 987 gain or loss with respect to that deferral QBU will be recognized. This paragraph (c)(2)(iii) does not affect the application of §§1.987–1 through 1.987–11 to the successor QBU owner with respect to its ownership of the successor QBU.

(3) *Recognition of deferred section 987 loss in certain outbound successor QBU terminations.* Notwithstanding paragraph (c)(2) of this section, if assets of the successor QBU (transferred assets) are transferred (or deemed transferred) in a transaction that would constitute an outbound loss event if the successor QBU had a net accumulated section 987 loss at the time of the exchange, then

the deferral QBU owner recognizes outstanding deferred section 987 loss, if any, to the extent it would recognize loss under paragraph (d)(1) of this section if (i) the deferral QBU owner owned the successor QBU, (ii) the deferral QBU owner had net unrecognized section 987 loss with respect to the successor QBU equal to its outstanding deferred section 987 loss with respect to the deferral QBU, and (iii) the transferred assets were transferred (or deemed transferred) in an outbound loss event. Any outstanding deferred section 987 loss with respect to the deferral QBU that is not recognized as a result of the preceding sentence is recognized by the deferral QBU owner in the first taxable year in which the deferral QBU owner (including any qualified successor) ceases to be a member of a controlled group that includes the acquirer of the transferred assets or any qualified successor of such acquirer.

(4) *Special rules regarding successor QBUs*—(i) *Successor QBU with respect to a deferral QBU that is a successor QBU.* If a section 987 QBU is a successor QBU with respect to a deferral QBU that is a successor QBU with respect to another deferral QBU, the first-mentioned section 987 QBU is considered a successor QBU with respect to the second-mentioned deferral QBU. For example, if QBU A is a successor QBU with respect to QBU B, and QBU B is a successor QBU with respect to QBU C, then QBU A is a successor QBU with respect to QBU C.

(ii) *Separation of a successor QBU.* If a successor QBU with respect to a deferral QBU separates into two or more separated QBUs (as defined in §1.987–2T(c)(9)(iii)), each separated QBU is considered a successor QBU with respect to the deferral QBU.

(iii) *Combination of a successor QBU.* If a successor QBU with respect to a deferral QBU combines with another section 987 QBU of the same owner, resulting in a combined QBU (as defined in §1.987–2T(c)(9)(i)), the combined QBU is considered a successor QBU with respect to the deferral QBU.

(d) *Loss recognition upon an outbound loss event*—(1) *In general.* Notwithstanding §1.987–5, the owner of a section 987 QBU with respect to which an outbound loss event occurs (an outbound loss QBU) includes in taxable income in the taxable year of an outbound loss event section 987 loss with respect to that section 987 QBU only to the extent provided in paragraph (d)(3) of this section.

(2) *Outbound loss event.* An outbound loss event means, with respect to a section 987 QBU:

(i) Any termination of the section 987 QBU in connection with a transfer by a U.S. person of assets of the section 987 QBU to a foreign person that is a member of the same controlled group as the U.S. transferor immediately before the transaction or, if the transferee did not exist immediately before the transaction, immediately after the transaction (related foreign person), provided that the termination would result in the recognition of section 987 loss with respect to the section 987 QBU under §1.987–5 and paragraph (b) of this section but for this paragraph (d);

(ii) Any transfer by a U.S. person of part of an interest in a section 987 aggregate partnership or DE through which the U.S. person owns the section 987 QBU to a related foreign person that has the same functional currency as the section 987 QBU, or any contribution by such a related foreign person to such a partnership or DE of assets that, immediately after the contribution, are not considered to be included on the books and records of an eligible QBU, provided that the transfer would result in the recognition of section 987 loss with respect to the section 987 QBU under §1.987–5 and paragraph (b) of this section but for this paragraph (d).

(3) *Loss recognized upon an outbound loss event.* In the taxable year of an outbound loss event with respect to an outbound loss QBU, the owner of the outbound loss QBU recognizes section 987 loss as determined under §1.987–5 and paragraphs (b) and (c) of this section, except that, solely for purposes of applying §1.987–5, the following assets and liabilities of the outbound loss QBU are treated as not having been transferred and therefore as remaining on the books and records of the outbound loss QBU notwithstanding the outbound loss event:

(i) In the case of an outbound loss event described in paragraph (d)(2)(i) of this section, assets and liabilities that, immediately after the outbound loss event, are reflected on the books and records of the related foreign person described in that paragraph or of a section 987 QBU owned by such related foreign person; and

(ii) In the case of an outbound loss event described in paragraph (d)(2)(ii) of this section, assets and liabilities that, immediately after the outbound loss event, are reflected on the books and records of the eligible QBU from which the assets and liabilities of the outbound loss QBU are allocated and not on the books and records of a section 987 QBU.

(4) *Adjustment of basis of stock received in certain nonrecognition transactions.* If an outbound loss event results from the transfer of assets of the outbound loss QBU in a transaction described in section 351 or section 361, the basis of the stock that is received in the transaction is increased by an amount equal to the section 987 loss that, as a result of this paragraph (d), is not recognized with respect to the outbound loss QBU in the taxable year of the outbound loss event (outbound section 987 loss).

(5) *Recognition of outbound section 987 loss that is not converted into stock basis.* Outbound section 987 loss attributable to an outbound loss event that is not described in paragraph (d)(4) of this section is recognized by the owner of the outbound loss QBU in the first taxable year in which the owner or any qualified successor of the owner ceases to be a member of a controlled group that includes the related foreign person referred to in paragraph (d)(2)(i) or (ii) of this section, or any qualified successor of such person.

(e) *Source and character*—(1) *Deferred section 987 gain or loss and certain outbound section 987 loss.* The source and character of deferred section 987 gain or loss recognized pursuant to paragraph (c) of this section, and of outbound section 987 loss recognized pursuant to paragraph (d)(5) of this section, is determined under §1.987–6 as if such deferred section 987 gain or loss were recognized pursuant to §1.987–5 without regard to this section on the date of the related deferral event or outbound loss event.

(2) *Outbound section 987 loss reflected in stock basis.* If loss is recognized on the sale or exchange of stock described in paragraph (d)(4) of this section within two years of the outbound loss event described in that paragraph, then, to the extent of the outbound section 987 loss, the source and character of the loss recognized on the sale or exchange is determined under §1.987–6 as if such loss were section 987 loss recognized pursuant to §1.987–5 without regard to this section on the date of the outbound loss event.

(f) *Definitions*—(1) *Controlled group.* For purposes of this section, a controlled group means all persons with the relationships to each other specified in sections 267(b) or 707(b).

(2) *Qualified successor.* For purposes of this section, a qualified successor with respect to a corporation (transferor corporation) means another corporation (acquiring corporation) that acquires the assets of the transferor corporation in a transaction described in section 381(a), but only if (A) the acquiring corporation is a domestic corporation and the transferor corporation was a domestic corporation, or (B) the acquiring corporation is a controlled foreign corporation (as defined in section 957(a)) (CFC) and the transferor corporation was a CFC. A qualified successor of a corporation includes the qualified successor of a qualified successor of the corporation.

(g) *Anti-abuse.* No section 987 loss is recognized under §1.987–5 or this section in connection with a transaction or series of transactions that are undertaken with a principal purpose of avoiding the purposes of this section.

(h) *Examples.* The following examples illustrate the application of this section. For purposes of the examples, DC1 is a domestic corporation that owns all of the stock of DC2, which is also a domestic corporation, and CFC1 and CFC2 are CFCs. In addition, DC1, DC2, CFC1, and CFC2 are members of a controlled group as defined in paragraph (f)(1) of this section, and the de minimis rule of paragraph (a)(3)(ii) of this section is not applicable. Finally, except as otherwise provided, Business A is a section 987 QBU with the euro as its functional

currency, there are no transfers between Business A and its owner, and Business A's assets are not depreciable or amortizable.

Example 1. Contribution of a section 987 QBU to a member of the controlled group. (i) *Facts.* DC1 owns all of the interests in Business A. The balance sheet of Business A reflects assets with an aggregate adjusted basis of €1,000x and no liabilities. DC1 contributes €900x of Business A's assets to DC2 in an exchange to which section 351 applies. Immediately after the contribution, the remaining €100x of Business A's assets are no longer reflected on the books and records of a section 987 QBU. DC2, which has the U.S. dollar as its functional currency, uses the former Business A assets in a business (Business B) that constitutes a section 987 QBU. At the time of the contribution, Business A has net accumulated unrecognized section 987 gain of $100x.

(ii) *Analysis.* (A) Under §1.987–2(c)(2)(ii), DC1's contribution of €900x of Business A's assets to DC2 is treated as a transfer of all of the assets of Business A to DC1, immediately followed by DC1's contribution of €900x of Business A's assets to DC2. The contribution of Business A's assets is a deferral event within the meaning of paragraph (b)(2) of this section because: (1) The transfer from Business A to DC1 is a transfer of substantially all of Business A's assets to DC1, resulting in a termination of Business A under §1.987–8(b)(2); and (2) immediately after the transaction, assets of Business A are reflected on the books and records of Business B, a section 987 QBU owned by a member of DC1's controlled group and a successor QBU within the meaning of paragraph (b)(4) of this section. Accordingly, Business A is a deferral QBU within the meaning of paragraph (b)(1) of this section, and DC1 is a deferral QBU owner of Business A within the meaning of paragraph (c)(1)(ii) of this section.

(B) Under paragraph (b)(3) of this section, DC1's taxable income in the taxable year of the deferral event includes DC1's section 987 gain or loss determined with respect to Business A under §1.987–5, except that, for purposes of applying §1.987–5, all assets and liabilities of Business A that are reflected on the books and records of Business B immediately after Business A's termination are treated as not having been transferred and therefore as though they remained on Business A's books and records (notwithstanding the deemed transfer of those assets under §1.987–8(e)). Accordingly, in the taxable year of the deferral event, DC1 is treated as making a remittance of €100x, corresponding to the assets of Business A that are no longer reflected on the books and records of a section 987 QBU, and is treated as having a remittance proportion with respect to Business A of 0.1, determined by dividing the €100x remittance by the sum of the remittance and the €900x aggregate adjusted basis of the gross assets deemed to remain on Business A's books at the end of the year. Thus, DC1 recognizes $10x of section 987 gain in the taxable year of the deferral event. DC1's deferred section 987 gain equals $90x, which is the amount of section 987 gain that, but for the application of paragraph (b) of this section, DC1 would have recognized under §1.987–5 ($100x), less the amount of section 987 gain recognized by DC1 under §1.987–5 and this section ($10x).

Example 2. Election to be classified as a corporation. (i) *Facts.* DC1 owns all of the interests in Entity A, a DE. Entity A conducts Business A, which has net accumulated unrecognized section 987 gain of $500x. Entity A elects to be classified as a corporation under §301.7701–3(a). As a result of the election and pursuant to §301.7701–3(g)(1)(iv), DC1 is treated as contributing all of the assets and liabilities of Business A to newly-formed CFC1, which has the euro as its functional currency. Immediately after the contribution, the assets and liabilities of Business A are reflected on CFC1's balance sheet.

(ii) *Analysis.* Under §1.987–2(c)(2)(ii), DC1's contribution of all of the assets and liabilities of Business A to CFC1 is treated as a transfer of all of the assets and liabilities of Business A to DC1, followed immediately by DC1's contribution of those assets and liabilities to CFC1. Because the deemed transfer from Business A to DC1 is a transfer of substantially all of Business A's assets to DC1, the Business A QBU terminates under §1.987–8(b)(2). The contribution of Business A's assets is not a deferral event within the meaning of paragraph (b)(2) of this section because, immediately after the transaction, no assets of Business A are reflected on the books and records of a successor QBU within the meaning of paragraph (b)(4) of this section due to the fact that the assets of Business A are not reflected on a section 987 QBU immediately after the termination as well as the fact that the requirement of paragraph (b)(4)(iii) of this section is not met. Accordingly, DC1 recognizes section 987 gain with respect to Business A under §1.987–5 without regard to this section. Because the requirement of paragraph (b)(4)(iii) of this section is not met, the result would be the same even if the assets of Business A were transferred in a section 351 exchange to an existing foreign corporation that had a different functional currency than Business A.

Example 3. Outbound loss event. (i) *Facts.* The facts are the same as in *Example 2*, except that Business A has net accumulated unrecognized section 987 loss of $500x rather than net accumulated unrecognized section 987 gain of $500x.

(ii) *Analysis.* (A) The analysis of the transactions under §§1.987–2(c)(2)(ii), 1.987–8(b)(2), and paragraph (b) of this section is the same

as in *Example 2*. However, the termination of Business A as a result of the transfer of the assets of Business A by a U.S. person (DC1) to a foreign person (CFC1) that is a member of DC1's controlled group is an outbound loss event described in paragraph (d)(2) of this section.

(B) Under paragraphs (d)(1) and (d)(3) of this section, in the taxable year of the outbound loss event, DC1 includes in taxable income section 987 loss recognized with respect to Business A as determined under §1.987–5, except that, for purposes of applying §1.987–5, all assets and liabilities of Business A that are reflected on the books and records of CFC1, a related foreign person described in paragraph (d)(2) of this section, are treated as not having been transferred. Accordingly, DC1's remittance proportion with respect to Business A is 0, and DC1 recognizes no section 987 loss with respect to Business A. DC1's outbound section 987 loss is $500x, which is the amount of section 987 loss that DC1 would have recognized under §1.987–5 ($500x) without regard to paragraph (d) of this section, less the amount of section 987 loss recognized by DC1 under paragraph (d)(3) of this section ($0). Under paragraph (d)(4) of this section, DC1 must increase its basis in its CFC1 shares by the amount of the outbound section 987 loss ($500x).

Example 4. Conversion of a DE to a partnership. (i) *Facts.* DC1 owns all of the interests in Entity A, a DE that conducts Business A. On the last day of Year 1, DC1 sells 50 percent of its interest in Entity A to DC2 (the Entity A sale).

(ii) *Analysis.* (A) For Federal income tax purposes, Entity A is converted to a partnership when DC2 purchases the 50 percent interest in Entity A. DC2's purchase is treated as the purchase of 50 percent of the assets of Entity A (that is, the assets of Business A), which, prior to the purchase, were treated as held directly by DC1 for Federal income tax purposes. Immediately after DC2's deemed purchase of 50 percent of Business A assets, DC1 and DC2 are treated as contributing their respective interests in Business A assets to a partnership. See Rev. Rul. 99–5 (1999–1 CB 434) (situation 1). These deemed transactions are not taken into account for purposes of this section, but the Entity A sale and resulting existence of a partnership have consequences under section 987 and this section, as described in paragraphs (ii)(B) through (D) of this *Example 4*.

(B) Immediately after the Entity A sale, Entity A is a section 987 aggregate partnership within the meaning of §1.987–1(b)(5) because DC1 and DC2 own all the interests in partnership capital and profits, DC1 and DC2 are related within the meaning of section 267(b), and the partnership has an eligible QBU (Business A) that would be a section 987 QBU with respect to a partner if owned by the partner directly. As a result of the Entity A sale, 50 percent of the assets and liabilities of Business A ceased to be reflected on the books and records of DC1's Business A section 987 QBU. As a result, such assets and liabilities are treated as if they were transferred from DC1's Business A section 987 QBU to DC1. Additionally, following DC2's acquisition of 50 percent of the interest in Entity A, DC2 is allocated 50 percent of the assets and liabilities of Business A under §§1.987–2(b), 1.987–7(a), and 1.987–7T(b). Because DC2 and Business A have different functional currencies, DC2's portion of the Business A assets and liabilities constitutes a section 987 QBU. Accordingly, 50 percent of the assets and liabilities of Business A are treated as transferred by DC2 to DC2's Business A section 987 QBU.

(C) The Entity A sale is a deferral event described in paragraph (b)(2) of this section because: (1) The sale constitutes the disposition of part of an interest in a DE; and (2) immediately after the transaction, assets of DC1's Business A section 987 QBU are reflected on the books and records of DC1's Business A section 987 QBU and DC2's Business A section 987 QBU, each of which is a successor QBU with respect to DC1's Business A section 987 QBU within the meaning of paragraph (b)(4) of this section. Accordingly, DC1's Business A section 987 QBU is a deferral QBU within the meaning of paragraph (b)(1) of this section, and DC1 is a deferral QBU owner within the meaning of paragraph (c)(1)(ii) of this section. Under paragraph (b)(1) of this section, DC1 includes in taxable income section 987 gain or loss with respect to Business A in connection with the deferral event to the extent provided in paragraphs (b)(3) and (c) of this section.

(D) Under paragraph (b) of this section, in the taxable year of the Entity A sale, DC1 includes in taxable income section 987 gain or loss with respect to Business A as determined under §1.987–5, except that, for purposes of applying §1.987–5, all assets and liabilities of Business A that, immediately after the Entity A sale, are reflected on the books and records of successor QBUs are treated as though they were not transferred and therefore as remaining on the books and records of DC1's Business A section 987 QBU notwithstanding the Entity A sale. Accordingly, DC1's remittance amount under §1.987–5 is $0, and DC1 recognizes no section 987 gain or loss with respect to Business A.

Example 5. Partial recognition of deferred gain or loss. (i) *Facts.* DC1 owns all of the interests in Entity A, a DE that conducts Business A in Country X. During Year 1, DC1 contributes all of its interests in Entity A to DC2 in an exchange to which section 351 applies. At the time of the contribution, Business A has net accumulated unrecognized section 987 gain of $100x. After the contribution, Entity A continues to conduct business

in Country X (Business B). In Year 3, as a result of a net transfer of property from Business B to DC2, DC2's remittance proportion with respect to Business B, as determined under §1.987–5, is 0.25.

(ii) *Analysis.* (A) For the reasons described in *Example 1*, the contribution of Entity A by DC1 to DC2 results in a termination of Business A and a deferral event with respect to Business A, a deferral QBU; DC1 is a deferral QBU owner within the meaning of paragraph (c)(1)(ii) of this section; Business B is a successor QBU with respect to Business A; DC2 is a successor QBU owner; and the $100x of net accumulated unrecognized section 987 gain with respect to Business A becomes deferred section 987 gain as a result of the deferral event.

(B) Under paragraph (c)(1) of this section, DC1 recognizes deferred section 987 gain with respect to Business A in accordance with paragraphs (c)(2) through (4) of this section. Under paragraph (c)(2)(i) of this section, DC1 recognizes deferred section 987 gain in Year 3 as a result of the remittance from Business B to DC2. Under paragraph (c)(2)(ii) of this section, the amount of deferred section 987 gain that DC1 recognizes is $25x, which is DC1's outstanding deferred section 987 gain or loss ($100x) with respect to Business A multiplied by the remittance proportion (0.25) of DC2 with respect to Business B for the taxable year as determined under §1.987–5(b).

(i) *Coordination with fresh start transition method*—(1) *In general.* If a taxpayer is a deferral QBU owner, or is or was the owner of an outbound loss QBU, and the taxpayer is required under §1.987–10(a) to apply the fresh start transition method described in §1.987–10(b) to the deferral QBU or outbound loss QBU, or would have been so required if the taxpayer had owned the deferral QBU or outbound loss QBU on the transition date (as defined in §1.987–11(c)), the adjustments described in paragraphs (i)(2) and (i)(3) of this section, as applicable, must be made on the transition date.

(2) *Adjustment to deferred section 987 gain or loss.* The amount of any outstanding deferred section 987 gain or loss of a deferral QBU owner with respect to a deferral QBU described in paragraph (i)(1) of this section must be adjusted to equal the amount of outstanding deferred section 987 gain or loss that the deferral QBU owner would have had with respect to the deferral QBU on the transition date if, immediately before the deferral event, the deferral QBU had transitioned to the method prescribed by §§1.987–1 through 1.987–10 pursuant to the fresh start transition method.

(3) *Adjustments in the case of an outbound loss event.* The basis of any stock described in paragraph (d)(4) of this section that was received in connection with the transfer (or deemed transfer) of assets of an outbound loss QBU described in paragraph (i)(1) of this section and that is held on the transition date must be adjusted to equal the basis that such stock would have had on the transition date if, immediately prior to the outbound loss event, the outbound loss QBU had transitioned to the method prescribed by §§1.987–1 through 1.987–10 pursuant to the fresh start transition method. If no such stock was received, the amount of any outbound section 987 loss with respect to the outbound loss QBU that may be recognized on or after the transition date pursuant to paragraph (d)(5) of this section must be adjusted to equal the amount of such loss that would be outstanding and that may be recognized pursuant to that paragraph if, immediately before the outbound loss event, the outbound loss QBU had transitioned to the method prescribed by §§1.987–1 through 1.987–10 pursuant to the fresh start transition method.

(j) *Effective/applicability date*—(1) *In general.* Except as described in paragraph (j)(2) of this section, this section applies to any deferral event or outbound loss event that occurs on or after January 6, 2017.

(2) *Exception.* This section applies to any deferral event or outbound loss event that occurs on or after December 7, 2016, if such deferral event or outbound loss event is undertaken with a principal purpose of recognizing section 987 loss.

(k) *Expiration date.* The applicability of this section expires December 6, 2019.

[T.D. 9795, 81 FR 88875, Dec. 8, 2016]

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

This section lists captioned paragraphs contained in §§1.988–1 through 1.988–6.

§1.988–1 Certain definitions and special rules.

(a) Section 988 transaction.