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(H) *Annual deemed termination election.* An election under §1.987–8T(d) for an owner to deem all of its section 987 QBUs to terminate on the last day of each taxable year must be titled ''Section 987 Annual Deemed Termination Election Under §1.987–8T(d)'' and must provide the name and address of each section 987 QBU to which the election applies, including a section 987 QBU owned by a related person (within the meaning of paragraph (g)(2)(i)(B)(*1*) of this section).

(g)(4) through (6) [Reserved]. For further guidance, see §1.987–1(g)(4) through (6).

(h) *Effective/applicability date.* Paragraphs (g)(2)(i)(B) and (g)(3)(i)(H) of this section apply to the first taxable year beginning on or after December 7, 2016. Paragraphs (b)(1)(iii), (b)(6), (c)(1)(ii)(B), (c)(3)(i)(E), (d)(3), (f), (g)(2)(i)(C), and (g)(3)(i)(E) through (G) of this section apply to taxable years beginning one year after the first day of the first taxable year following December 7, 2016. Notwithstanding the preceding sentence, if a taxpayer makes an election under §1.987–11(b), then paragraphs (b)(1)(iii), (b)(6), (c)(1)(ii)(B), (c)(3)(i)(E), (d)(3), (f), (g)(2)(i)(C), and (g)(3)(i)(E) through (G) of this section apply to taxable years to which §§1.987–1 through 1.987–10 apply as a result of such election.

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

[T.D. 9795, 81 FR 88868, Dec. 8, 2016]

§1.987–2 Attribution of items to eligible QBUs; definition of a transfer and related rules.

(a) *Scope and general principles.* Paragraph (b) of this section provides rules for attributing assets and liabilities, and items of income, gain, deduction, and loss, to an eligible QBU. Assets and liabilities are attributed to a section 987 QBU for purposes of section 987. Items of income, gain, deduction, and loss are attributed to a section 987 QBU for purposes of computing the section 987 taxable income of the section 987 QBU and of its owner. Paragraph (c) of this section defines a transfer to or from a section 987 QBU. Paragraph (d) of this section provides translation rules for transfers to a section 987 QBU.

(b) *Attribution of items to an eligible QBU*—(1) *General rules.* Except as provided in paragraphs (b)(2) and (3) of this section, items are attributable to an eligible QBU to the extent they are reflected on the separate set of books and records, as defined in §1.989(a)–1(d), of the eligible QBU. In the case of a section 987 aggregate partnership, items reflected on the books and records of the partnership and deemed allocated to an eligible QBU of such partnership are considered to be reflected on the books and records of such eligible QBU. For purposes of this section, the term ''item'' refers to any asset or liability, and any item of income, gain, deduction, or loss. Items that are attributed to an eligible QBU pursuant to this section must be adjusted to conform to Federal income tax principles. Except as provided in §1.989(a)–1(d)(3), these attribution rules apply solely for purposes of section 987. For example, the allocation and apportionment of interest expense under section 864(e) is independent of the rules under section 987.

(2) *Exceptions for non-portfolio stock, interests in partnerships, and certain acquisition indebtedness.* The following items shall not be considered to be on the books and records of an eligible QBU:

(i) Stock of a corporation (whether domestic or foreign), other than stock of a corporation reflected on the books and records (within the meaning of paragraph (b)(1) of this section) of an eligible QBU if the owner of the eligible QBU owns less than 10 percent of the total value of all classes of stock of such corporation. For this purpose, section 318(a) applies in determining ownership, except that in applying section 318(a)(2)(C), the phrase ''10 percent'' is used instead of the phrase ''50 percent.''

(ii) An interest in a partnership (whether domestic or foreign).

(iii) A liability that was incurred to acquire stock described in paragraph (b)(2)(i) of this section or that was incurred to acquire a partnership interest described in paragraph (b)(2)(ii) of this section.

(iv) Income, gain, deduction, or loss arising from the items described in paragraphs (b)(2)(i) through (iii) of this

section. For example, a section 951 inclusion with respect to stock of a foreign corporation described in paragraph (b)(2)(i) of this section shall not be considered to be on the books and records of an eligible QBU.

(3) *Adjustments to items reflected on the books and records*—(i) *General rule.* If a principal purpose of recording (or failing to record) an item on the books and records of an eligible QBU is the avoidance of Federal income tax under, or through the use of, section 987, the item must be allocated between or among the eligible QBU, the owner of such eligible QBU, and any other persons, entities (including DEs), or other QBUs within the meaning of §1.989(a)–1(b) (including eligible QBUs) in a manner that reflects the substance of the transaction. For purposes of this paragraph (b)(3)(i), relevant factors for determining whether such Federal income tax avoidance is a principal purpose of recording (or failing to record) an item on the books and records of an eligible QBU shall include, but are not limited to, the factors set forth in paragraphs (b)(3)(ii) and (iii) of this section. The presence or absence of any factor or factors is not determinative. Moreover, the weight given to any factor (whether or not set forth in paragraphs (b)(3)(ii) and (iii) of this section) depends on the particular case.

(ii) *Factors indicating no tax avoidance.* For purposes of paragraph (b)(3)(i) of this section, factors that may indicate that recording (or failing to record) an item on the books and records of an eligible QBU did not have as a principal purpose the avoidance of Federal income tax under, or through the use of, section 987 include the recording (or not recording) of an item:

(A) For a significant and bona fide business purpose;

(B) In a manner that is consistent with the economics of the underlying transaction;

(C) In accordance with generally accepted accounting principles (or similar comprehensive accounting standard);

(D) In a manner that is consistent with the treatment of similar items from year to year;

(E) In accordance with accepted conditions or practices in the particular trade or business of the eligible QBU;

(F) In a manner that is consistent with an explanation of existing internal accounting policies that is evidenced by documentation contemporaneous with the timely filing of a Federal income tax return for the taxable year; and

(G) As a result of a transaction between legal entities (for example, the transfer of an asset or the assumption of a liability), even if such transaction is not regarded for Federal income tax purposes (for example, a transaction between a DE and its owner).

(iii) *Factors indicating tax avoidance.* For purposes of paragraph (b)(3)(i) of this section, factors that may indicate that a principal purpose of recording (or failing to record) an item on the books and records of an eligible QBU is the avoidance of Federal income tax under, or through the use of, section 987 include:

(A) The presence or absence of an item on the books and records that is the result of one or more transactions that are transitory, for example, due to a circular flow of cash or other property;

(B) The presence or absence of an item on the books and records that is the result of one or more transactions that do not have substance;

(C) The presence or absence of an item on the books and records that results in the taxpayer (or a person related to the taxpayer within the meaning of section 267(b) or section 707(b)) having offsetting positions with respect to the functional currency of a section 987 QBU; and

(D) The absence of any or all of the factors listed in paragraph (b)(3)(ii) of this section.

(4) *Assets and liabilities of a section 987 aggregate partnership or DE that are not attributed to an eligible QBU.* Neither a section 987 aggregate partnership nor a DE is an eligible QBU and, thus, neither entity can be a section 987 QBU. See §1.987–1(b)(2) and (3). As a result, a section 987 aggregate partnership or DE may own assets and liabilities that are not attributed to an eligible QBU as provided under this paragraph (b)

and, therefore, are not subject to section 987. For the foreign currency treatment of such assets or liabilities, see §1.988–1(a)(4).

(c) *Transfers to and from section 987 QBUs*—(1) *In general.* The following rules apply for purposes of determining whether there is a transfer of an asset or a liability from an owner to a section 987 QBU, or from a section 987 QBU to an owner. These rules apply solely for purposes of section 987.

(2) *Disregarded transactions*—(i) *General rule.* An asset or liability shall be treated as transferred to a section 987 QBU from its owner (whether direct owner or indirect owner, as defined in §1.987–1(b)(4)) if, as a result of a disregarded transaction (as defined in paragraph (c)(2)(ii) of this section), such asset or liability is reflected on the books and records of the section 987 QBU within the meaning of paragraph (b) of this section. Similarly, an asset or liability shall be treated as transferred from a section 987 QBU to its owner if, as a result of a disregarded transaction, such asset or liability is no longer reflected on the books and records of the section 987 QBU within the meaning of paragraph (b) of this section.

(ii) *Definition of a disregarded transaction.* For purposes of this section, a disregarded transaction means a transaction that is not regarded for Federal income tax purposes (for example, any transaction between separate section 987 QBUs of the same owner). For purposes of this paragraph (c), a disregarded transaction shall be treated as including the recording of an asset or liability on the books and records of an eligible QBU (as defined in §1.987–1(b)(3)) of an owner, if the recording is the result of such asset or liability being removed from the books and records of a separate eligible QBU of the same owner, whether such separate eligible QBU is owned directly or is owned indirectly through the same entity (including through a DE or a section 987 aggregate partnership). Additionally, if an asset or liability that is attributable to a section 987 QBU within the meaning of paragraph (b) of this section is sold or exchanged (including in a nonrecognition transaction, such as an exchange under section 351) for an asset or liability that is not attributable to the section 987 QBU immediately after the sale or exchange, the sold or exchanged asset or liability that was attributable to the section 987 QBU immediately before the transaction shall be treated as transferred from the section 987 QBU to its direct or indirect owner in a disregarded transaction immediately before the sale or exchange for purposes of section 987 (including for purposes of recognizing section 987 gain or loss under §1.987–5) and subsequently sold or exchanged by the owner. The preceding sentence shall not apply with respect to an acquisition or disposition of an interest in a section 987 aggregate partnership or in a DE, as described in paragraph (c)(5) of this section.

(iii) *Items derived from disregarded transactions ignored.* For purposes of section 987, disregarded transactions shall not give rise to items of income, gain, deduction, or loss that are taken into account in determining section 987 taxable income or loss under §1.987–3.

(3) *Transfers of assets to and from section 987 QBUs owned through section 987 aggregate partnerships*—(i) *Contributions to section 987 aggregate partnerships.* Solely for purposes of section 987, an asset shall be treated as transferred by an indirect owner (as defined in §1.987–1(b)(4)(ii)) to a section 987 QBU of a partner (as defined in §1.987–1(b)(5)(ii)) to the extent the indirect owner contributes the asset to the section 987 aggregate partnership that carries on the activities of the section 987 QBU, provided that, immediately prior to the contribution, the asset is not reflected on the books and records of the section 987 QBU within the meaning of paragraph (b) of this section and the asset is reflected on the books and records of the section 987 QBU immediately following such contribution. For purposes of this paragraph (c)(3)(i), deemed contributions of money described under section 752 shall be disregarded. See paragraph (c)(4)(ii) of this section for rules governing the assumption by a partner of liabilities of a section 987 aggregate partnership.

(ii) *Distributions from section 987 aggregate partnerships.* Solely for purposes of section 987, an asset shall be treated as transferred from a section 987 QBU of a

partner to its indirect owner to the extent the section 987 aggregate partnership that carries on the activities of the section 987 QBU distributes the asset to the indirect owner, provided that, immediately prior to such distribution, the asset is reflected on the books and records of the section 987 QBU within the meaning of paragraph (b) of this section, and the asset is not reflected on the books and records of the section 987 QBU immediately after such distribution. For purposes of this paragraph (c)(3)(ii), deemed distributions of money described under section 752 shall be disregarded. See paragraph (c)(4)(i) of this section for rules governing the assumption by a section 987 aggregate partnership of liabilities of a partner.

(4) *Transfers of liabilities to and from section 987 QBUs owned through section 987 aggregate partnerships*—(i) *Assumptions of partner liabilities.* Solely for purposes of section 987, a liability of the owner of a section 987 aggregate partnership shall be treated as transferred to a section 987 QBU of a partner if, and to the extent, the section 987 aggregate partnership assumes such liability, provided that, immediately prior to the transfer, the liability is not reflected on the books and records of the section 987 QBU within the meaning of paragraph (b) of this section, and the liability is reflected on the books and records of the section 987 QBU immediately following the transfer.

(ii) *Assumptions of section 987 aggregate partnership liabilities.* Solely for purposes of section 987, a liability of a section 987 aggregate partnership shall be treated as transferred from a section 987 QBU of a partner to its indirect owner if, and to the extent, the indirect owner assumes such liability of the section 987 aggregate partnership, provided that, immediately prior to such assumption, the liability is reflected on the books and records of the section 987 QBU within the meaning of paragraph (b) of this section, and the liability is not reflected on the books and records of the section 987 QBU immediately following the transfer.

(5) *Acquisitions and dispositions of interests in DEs and section 987 aggregate partnerships.* Solely for purposes of section 987, an asset or liability shall be treated as transferred to a section 987 QBU from its owner if, as a result of an acquisition (including by contribution) or disposition of an interest in a section 987 aggregate partnership or DE, such asset or liability is reflected on the books and records of the section 987 QBU. Similarly, an asset or liability shall be treated as transferred from a section 987 QBU to its owner if, as a result of an acquisition or disposition of an interest in a section 987 aggregate partnership or DE, the asset or liability is not reflected on the books and records of the section 987 QBU.

(6) *Changes in form of ownership.* For purposes of this paragraph (c), mere changes in the form of ownership of an eligible QBU shall not result in a transfer to or from a section 987 QBU. Instead, the determination of whether a transfer has occurred in such case shall be made under paragraph (c)(5) of this section. For example, a transaction that causes a direct owner of an eligible QBU to become an indirect owner of the eligible QBU shall not, except to the extent provided in paragraph (c)(5) of this section, result in a transfer to or from a section 987 QBU. See, for example, Rev. Rul. 99–5 (1999–1 CB 434), Rev. Rul. 99–6 (1999–1 CB 432), §601.601(d)(2) of this chapter, and section 708 and the applicable regulations.

(7) *Application of general tax law principles.* General tax law principles, including the circular cash flow, step-transaction, economic substance, and substance-over-form doctrines, apply for purposes of determining whether there is a transfer of an asset or liability under this paragraph (c), including a transfer of an asset or liability pursuant to a disregarded transaction (as defined in paragraph (c)(2)(ii) of this section).

(8) *Interaction with §1.988–1(a)(10).* See §1.988–1(a)(10) for rules regarding the treatment of an intra-taxpayer transfer of a section 988 transaction.

(9) [Reserved]. For further guidance, see §1.987–2T(c)(9).

(10) *Examples.* The following examples illustrate the principles of this paragraph (c). For purposes of the examples, X and Y are domestic corporations, have the U.S. dollar as their

functional currency, and use the calendar year as their taxable years. Furthermore, except as otherwise provided, Business A and Business B are eligible QBUs that have the euro and the Japanese yen, respectively, as their functional currencies, and DE1 and DE2 are DEs. For purposes of determining whether any of the transfers in these examples result in remittances, see §1.987–5.

Example 1. Transfer to a directly owned section 987 QBU. (i) *Facts.* X owns all of the interests in DE1. DE1 owns Business A, which is a section 987 QBU of X. X owns €100 that are not reflected on the books and records of Business A. Business A is in need of additional capital and, as a result, X lends the €100 to DE1 for use in Business A in exchange for a note.

(ii) *Analysis.* (A) The loan from X to DE1 is not regarded for Federal income tax purposes (because it is an interbranch transaction) and therefore is a disregarded transaction (as defined in paragraph (c)(2)(ii) of this section). As a result, the DE1 note held by X and the liability of DE1 under the note are not taken into account under this section.

(B) As a result of the disregarded transaction, the €100 is reflected on the books and records of Business A. Therefore, X is treated as transferring €100 to its Business A section 987 QBU for purposes of section 987. This transfer is taken into account in determining the amount of any remittance for the taxable year under §1.987–5(c). See §1.988–1(a)(10)(ii) for the application of section 988 to X as a result of the transfer of non-functional currency to its section 987 QBU.

Example 2. Transfer to a directly owned section 987 QBU. (i) *Facts.* X owns Business A and Business B, both of which are section 987 QBUs of X. X owns equipment that is used in Business A and is reflected on the books and records of Business A. Because Business A has excess manufacturing capacity and X intends to expand the manufacturing capacity of Business B, the equipment formerly used in Business A is transferred to Business B for use by Business B. As a result of the transfer, the equipment is removed from the books and records of Business A and is recorded on the books and records of Business B.

(ii) *Analysis.* The transfer of the equipment from the books and records of Business A to the books and records of Business B is not regarded for Federal income tax purposes (because it is an interbranch transaction), and therefore it is a disregarded transaction for purposes of this paragraph (c). Therefore, for purposes of section 987, the Business A section 987 QBU is treated as transferring the equipment to X, and X is subsequently treated as transferring the equipment to the Business B section 987 QBU. These transfers are taken into account in determining the amount of any remittance for the taxable year under §1.987–5(c).

Example 3. Intracompany sale of property between two section 987 QBUs. (i) *Facts.* X owns all of the interests in DE1 and DE2. DE1 and DE2 own Business A and Business B, respectively, both of which are section 987 QBUs of X. DE1 owns equipment that is used in Business A and is reflected on the books and records of Business A. For business reasons, DE1 sells a portion of the equipment used in Business A to DE2 in exchange for a fair market value amount of Japanese yen. The yen used by DE2 to acquire the equipment was generated by Business B and was reflected on Business B's books and records. Following the sale, the yen and the equipment will be used in Business A and Business B, respectively. As a result of such sale, the equipment is removed from the books and records of Business A and is recorded on the books and records of Business B. Similarly, as a result of the sale, the yen is removed from the books and records of Business B and is recorded on the books and records of Business A.

(ii) *Analysis.* (A) The sale of equipment between DE1 and DE2 is a transaction that is not regarded for Federal income tax purposes (because it is an interbranch transaction). Therefore the transaction is a disregarded transaction for purposes of paragraph (c) of this section. As a result, the sale is not taken into account under this section and, pursuant to paragraph (c)(2)(iii) of this section, the sale does not give rise to an item of income, gain, deduction, or loss for purposes of determining section 987 taxable income or loss under §1.987–3. However, the yen and equipment exchanged by DE1 and DE2 in connection with the sale must be taken into account as a disregarded transaction under this paragraph (c).

(B) As a result of the disregarded transaction, the equipment ceases to be reflected on the books and records of Business A and becomes reflected on the books and records of Business B. Therefore, the Business A section 987 QBU is treated as transferring the equipment to X, and X is subsequently treated as transferring such equipment to the Business B section 987 QBU.

(C) Additionally, as a result of the disregarded transaction, the yen currency ceases to be reflected on the books and records of Business B and becomes reflected on the books and records of Business A. Therefore, the Business B section 987 QBU is treated as transferring the yen to X, and X is subsequently treated as transferring such yen from X to the Business A section 987 QBU. The transfers among Business A, Business B and X are taken into account in determining the amount of any remittance for the taxable year under §1.987–5(c).

Example 4. Sale of property by a section 987 QBU to a corporation that is a member of the consolidated group. (i) *Facts.* X owns all of the stock of Y and all of the interests in DE1. DE1 owns Business A. X and Y file a consolidated return. Business A sells property to Y for €100.

(ii) *Analysis.* The sale of property by Business A to Y is not considered a transfer of property to X (and a corresponding transfer from X to Y) under paragraph (c) of this section because the transaction is regarded for Federal income tax purposes. Rather, for purposes of section 987, the transaction is considered to occur between Business A and Y.

Example 5. Transactions of a section 987 QBU owned through an aggregate partnership. (i) *Facts.* (A) X owns all of the stock of Y and a 50 percent interest in the capital and profits of P, a partnership. Y owns the other 50 percent interest in P. P owns 100 percent of the interests in DE1 and DE2. DE1 owns Business A and DE2 owns Business B.

(B) In connection with Business A, DE1 licenses intangible property to both DE2 and X. X enters into the license agreement in a transaction other than in its capacity as a partner of P and, therefore, the license is considered as occurring between P and one who is not a partner within the meaning of section 707(a). X uses the intangible property in its own trade or business in the U.S. DE2 uses the intangible property in Business B. Pursuant to the license agreement, X and DE2 pay a €30 and a €50 royalty, respectively, to DE1.

(ii) *Analysis.* (A) Under §1.987–1(b)(5)(i), P is a section 987 aggregate partnership because X and Y own all the interests in partnership capital and profits, X and Y are related within the meaning of section 267(b), and the requirements of §1.987–1(b)(5)(i)(B) are satisfied. X and Y each have a 50 percent allocable share of the assets and liabilities of Business A and Business B, as determined under §1.987–7. Under §1.987–1(b)(5)(ii), the assets and liabilities of Business A allocated to X are a section 987 QBU of X, and the assets and liabilities of Business A allocated to Y are a section 987 QBU of Y. Likewise, the assets and liabilities of Business B allocated to X are a section 987 QBU of X, and the assets and liabilities of Business B allocated to Y are a section 987 QBU of Y.

(B) The license from DE1 to DE2 is not regarded for Federal income tax purposes (because it is an interbranch agreement) and, as a result, royalty payments under the license are disregarded transactions. Thus, pursuant to paragraph (c)(2)(iii) of this section, DE1's receipt of the royalty pursuant to the license agreement does not give rise to an item of income, gain, deduction, or loss for purposes of determining section 987 taxable income or loss under §1.987–3. However, the €50 that is paid from DE2 to DE1 pursuant to the license agreement must be taken into account under paragraph (c) of this section. Accordingly, €50 ceases to be reflected on the books and records of Business B and becomes reflected on the books and records of Business A. As a result, a 50 percent allocable share of the €50 royalty payment (€25) is treated as transferred from each of the Business B section 987 QBUs of X and Y, to X and Y, respectively. And subsequently, X and Y are treated as transferring their respective receipts of €25 to their respective Business A section 987 QBUs. These transfers are taken into account in determining the amount of any remittance to either of X or Y for the taxable year under §1.987–5(c).

(C) The €30 royalty payment from X to DE1 is regarded for Federal income tax purposes (because it is a payment from a partnership to a separate entity). Accordingly, the royalty payment is not a disregarded transaction for purposes of this paragraph (c) and is therefore not treated as a transfer of an asset from an owner to a section 987 QBU. As a result, the payment is not taken into account in determining the amount of any remittance for the taxable year under §1.987–5(c). Instead, the payment gives rise to an item of income and deduction that must be taken into account in computing section 987 taxable income or loss of Business A pursuant to §1.987–3.

Example 6. Acquisition of an interest in a partnership. (i) *Facts.* (A) X owns all of the stock of Z, a domestic corporation with the dollar as its functional currency. X also owns all of the stock of Y and a 50 percent interest in the capital and profits of P, a partnership. Y owns the other 50 percent interest in P. P owns Business A, and P owns no other assets or liabilities other than those of Business A.

(B) Z contributes cash to P in exchange for a 20 percent interest in the capital and profits of P. The cash Z contributes to P is used in Business A and is reflected on Business A's books and records.

(ii) *Analysis.* (A) Under §1.987–1(b)(5)(i), P is a section 987 aggregate partnership because X and Y own all the interests in partnership capital and profits, X and Y are related within the meaning of section 267(b), and the requirements of §1.987–1(b)(5)(i)(B) are satisfied. Prior to the contribution to P by Z, X and Y each have a 50 percent allocable share of the assets and liabilities of Business A, as determined under §1.987–7. Under §1.987–1(b)(5)(ii), the assets and liabilities of Business A allocated to X are a section 987 QBU of X, and the assets and liabilities of Business A allocated to Y are a section 987 QBU of Y.

(B) Following Z's acquisition of a 20 percent interest in P, P remains a section 987 aggregate partnership because X, Y and Z own all the interests in partnership capital and profits; X, Y, and Z are related within

the meaning of section 267(b); and the requirements of §1.987–1(b)(5)(i)(B) are satisfied. Z acquires a 20 percent allocable share of the assets and liabilities of Business A, as determined under §1.987–7. Under §1.987–1(b)(5)(ii), the assets and liabilities of Business A allocated to Z are a section 987 QBU of Z (because Z becomes an indirect owner of Business A and Z and Business A have different functional currencies).

(C) As a result of Z's contribution of cash to Business A, through its contribution to P, each of X, Y, and Z are allocated a share of that Business A asset. Accordingly, under §1.987–2(c)(5), Z is treated as contributing its allocable share of the cash to its Business A section 987 QBU. In addition, Z is treated as transferring X's and Y's respective allocable shares of the cash to X and Y, and X and Y are subsequently treated as transferring that cash to their respective Business A section 987 QBUs.

(D) In addition, as a result of Z's acquisition of its interest in P and Z's consequent acquisition of a Business A section 987 QBU, Z's allocable portion of the assets and liabilities of Business A (other than the cash) cease being reflected on the books and records of the respective Business A section 987 QBUs of each of X and Y. Those allocable portions of assets and liabilities from the Business A section 987 QBUs of X and Y are treated as if they are transferred from such section 987 QBUs to their respective owners, X and Y. These assets and liabilities are consequently recorded on the books and records of Z's Business A section 987 QBU. Accordingly, X and Y are treated as transferring those assets and liabilities to Z, and Z is treated as contributing those assets and liabilities to its new Business A section 987 QBU.

Example 7. Acquisition of an interest in a partnership. (i) *Facts.* The facts are the same as in *Example 6*, except that the cash that Z contributes to P in exchange for a 20 percent interest in P is not used in Business A and is not reflected on Business A's books and records. Instead, the cash is reflected on P's books and records.

(ii) *Analysis.* (A) Following Z's acquisition of a 20 percent interest in P, P remains a section 987 aggregate partnership because X, Y and Z own all the interests in partnership capital and profits; X, Y, and Z are related within the meaning of section 267(b); and the requirements of §1.987–1(b)(5)(i)(B) are satisfied. Z acquires a 20 percent allocable share of the assets and liabilities of Business A, as determined under §1.987–7. Under §1.987–1(b)(5)(ii), the assets and liabilities of Business A allocated to Z are a section 987 QBU of Z (because Z becomes an indirect owner of Business A and Z and Business A have different functional currencies).

(B) As a result of Z's acquisition of its interest in P and Z's consequent acquisition of a Business A section 987 QBU, Z's allocable portion of the assets and liabilities of Business A cease being reflected on the books and records of the respective Business A section 987 QBUs of each of X and Y. Those allocable portions of assets and liabilities from the Business A section 987 QBUs of X and Y are treated as if they are transferred from such section 987 QBUs to their respective owners, X and Y. These assets and liabilities are consequently recorded on the books and records of Z's Business A section 987 QBU. Accordingly, X and Y are treated as transferring those assets and liabilities to Z, and Z is treated as contributing those assets and liabilities to its new Business A section 987 QBU.

Example 8. Conversion of a DE to a partnership through a sale of an interest. (i) *Facts.* X owns all of the stock of Y and all of the interests in DE1. DE1 owns Business A. Y acquires 50 percent of the DE1 interests from X for cash.

(ii) *Analysis.* (A) DE1 is converted to a partnership when Y purchases the 50 percent interest in DE1. For Federal income tax purposes, Y's purchase of 50 percent of X's interest in DE1 is treated as the direct purchase of 50 percent of the assets of Business A because DE1 is disregarded and Business A is treated as held directly by X. Immediately after the sale of 50 percent of Business A to Y, X and Y are treated as contributing their respective interests in the assets of Business A to a partnership. See Rev. Rul. 99–5 (1999–1 CB 434) (situation 1) and §601.601(d)(2) of this chapter.

(B) For purposes of this paragraph (c), these deemed transactions are disregarded transactions. Under §1.987–1(b)(5)(i), the newly formed partnership is a section 987 aggregate partnership because X and Y own all the interests in partnership capital and profits, X and Y are related within the meaning of section 267(b), and the requirements of §1.987–1(b)(5)(i)(B) are satisfied. Because Y is a partner in a section 987 aggregate partnership that owns Business A and because Y and Business A have different functional currencies, Y's portion of the Business A assets and liabilities constitutes a section 987 QBU of Y.

(C) As a result of the conversion of DE1 to a partnership, Y acquires an allocable share of 50 percent of the assets and liabilities of Business A, as determined under §1.987–7. Accordingly, 50 percent of the assets and liabilities of Business A cease being reflected on the books and records of X's section 987 QBU. Under §1.987–2(b)(5), these amounts are treated as if they are transferred from X's section 987 QBU to X, and X is treated as transferring these assets and liabilities to Y. Accordingly, the assets and liabilities of Business A allocated to Y are treated as transferred by Y to Y's newly formed Business A section 987 QBU.

Example 9. Conversion of a DE to a partnership through a contribution. (i) *Facts.* X owns all of the stock of Y and all of the interests in DE1. DE1 owns Business A. Y contributes property (that is not then attributed to a section 987 QBU of Y) to DE1 in exchange for an interest in DE1. The property transferred by Y to DE1 is used in Business A and is reflected on the books and records of Business A.

(ii) *Analysis.* (A) DE1 is converted to a partnership when Y contributes property to DE1 in exchange for a 50 percent interest in DE1. For Federal income tax purposes, Y's contribution is treated as a contribution to a partnership in exchange for an ownership interest in the partnership. X is treated as contributing all of Business A to the partnership in exchange for a partnership interest. See Rev. Rul. 99–5 (situation 2), (1999–1 CB 434) and §601.601(d)(2) of this chapter.

(B) For purposes of this paragraph (c), these deemed transactions are disregarded transactions. Under §1.987–1(b)(5)(i), the newly formed partnership is a section 987 aggregate partnership because X and Y own all the interests in partnership capital and profits, X and Y are related within the meaning of section 267(b), and the requirements of §1.987–1(b)(5)(i)(B) are satisfied. Because Y is a partner in a section 987 aggregate partnership that owns Business A and because Y and Business A have different functional currencies, Y's portion of the Business A assets and liabilities constitutes a section 987 QBU of Y.

(C) As a result of the conversion of DE1 to a partnership, Y acquires an allocable share of 50 percent of the assets and liabilities of Business A, as determined under §1.987–7. Accordingly, under §1.987–2(c)(5), Y is treated as contributing its allocable share of its contributed property to its Business A section 987 QBU. In addition, Y is treated as transferring X's allocable share of the contributed property to X, and X is subsequently treated as transferring that property to its Business A section 987 QBUs. In addition, Y's allocable share of the original (pre-conversion) assets and liabilities of Business A cease being reflected on the books and records of X's section 987 QBU. Under §1.987–2(b)(5), these amounts are treated as if they are transferred from X's section 987 QBU to X, and X is treated as transferring these assets and liabilities to Y. Y is subsequently treated as transferring these assets and liabilities to Y's Business A section 987 QBU.

Example 10. Contribution of assets to a corporation. (i) *Facts.* X owns Business A. X forms Z, a domestic corporation, contributing 50 percent of its Business A assets and liabilities to Z in exchange for all of the stock of Z. X and Z do not file a consolidated tax return.

(ii) *Analysis.* Pursuant to paragraph (b)(2) of this section, the Z stock received in exchange for 50 percent of Business A's assets and liabilities is not reflected on the books and records of, and therefore is not attributable to, Business A for purposes of section 987 immediately after the exchange. As a result, pursuant to paragraph (c)(2)(i) and (ii) of this section, 50 percent of the assets and liabilities of Business A are treated as transferred from Business A to X in a disregarded transaction immediately before the exchange. The result would be the same even if X and Z filed a consolidated return.

Example 11. Circular transfers. (i) *Facts.* X owns Business A. On December 30, 2021, Business A purports to transfer €100 to X. On January 2, 2022, X purports to transfer €50 to Business A. On January 4, 2022, X purports to transfer another €50 to Business A. As of the end of 2021, X has an unrecognized section 987 loss with respect to Business A, such that a remittance, if respected, would result in recognition of a foreign currency loss under section 987.

(ii) *Analysis.* Because the transfer by Business A to X is offset by the transfers from X to Business A that occurred in close temporal proximity, the Internal Revenue Service (IRS) may disregard the purported transfers to and from Business A for purposes of section 987 pursuant to general tax principles under paragraph (c)(7) of this section.

Example 12. Transfers without substance. (i) *Facts.* X owns Business A and Business B. On January 1, 2021, Business A purports to transfer €100 to X. On January 4, 2021, X purports to transfer €100 to Business B. The account in which Business B deposited the €100 is used to pay the operating expenses and other costs of Business A. As of the end of 2021, X has an unrecognized section 987 loss with respect to Business A, such that a remittance, if respected, would result in recognition of a foreign currency loss under section 987.

(ii) *Analysis.* Because Business A continues to have use of the transferred property, the IRS may disregard the €100 purported transfer from Business A to X for purposes of section 987 pursuant to general tax principles under paragraph (c)(7) of this section.

Example 13. Offsetting positions in section 987 QBUs. (i) *Facts.* X owns Business A and Business B. Each of Business A and Business B has the euro as its functional currency. X has not made a grouping election under §1.987–1(b)(2)(ii). On January 1, 2021, X borrows €1,000 from a third party lender, records the liability with respect to the borrowing on the books and records of Business A, and records the borrowed €1,000 on the books and records of Business B. On December 31, 2022, when Business A has $100 of net unrecognized section 987 loss and Business B has $100 of net unrecognized section 987 gain resulting from the change in exchange rates with respect to the liability and the €1,000, X terminates the Business A section 987 QBU.

(ii) *Analysis.* Because Business A and Business B have offsetting positions in the euro, the IRS will scrutinize the transaction under paragraph (b)(3) of this section to determine if a principal purpose of recording the euro-denominated liability on the books and records of Business A and the borrowed euros on the books and records of Business B was the avoidance of tax under section 987. If such a principal purpose is present, the IRS may reallocate the items (that is, the euros and the euro-denominated liability) between Business A, Business B, and X, under paragraph (c)(7) of this section to reflect the substance of the transaction.

Example 14. Offsetting positions with respect to a section 987 QBU and a section 988 transaction. (i) *Facts.* X owns all of the interests in DE1, and DE1 owns Business A. On January 1, 2021, X borrows €1,000 from a third party lender and records the liability with respect to the borrowing on its books and records. X contributes the €1,000 loan proceeds to DE1 and the €1,000 are reflected on the books and records of Business A. On December 31, 2022, when Business A has $100 of net unrecognized section 987 loss resulting from the change in exchange rates with respect to the €1,000 received from the borrowing, and when the euro-denominated borrowing, if repaid, would result in $100 of gain under section 988, X terminates the Business A section 987 QBU.

(ii) *Analysis.* Because X and Business A have offsetting positions in the euro, the IRS will scrutinize the transaction under paragraph (b)(3) of this section to determine whether a principal purpose of recording the borrowed euros on the books and records of Business A, or not recording the corresponding euro-denominated liability on the books and records of Business A, was the avoidance of tax under section 987. If such a principal purpose is present, the Commissioner may reallocate the items (that is, the euros and the euro-denominated liability) between Business A and X under paragraph (c)(7) of this section to reflect the substance of the transaction.

Example 15. Offsetting positions with respect to a section 987 QBU and a section 988 transaction. (i) *Facts.* X owns all of the stock of Y and all of the interests in DE1. DE1 owns Business A. X and Y file a consolidated return. On January 1, 2021, DE1 lends €1,000 to Y. X records the receivable with respect to the loan on Business A's books and records. On December 31, 2022, when Business A has $100 of net unrecognized section 987 gain resulting from the loan, Y repays the €1,000 liability. The repayment of the euro-denominated borrowing results in $100 of loss to Y under section 988. X claims a $100 loss on its consolidated return under section 988. Business A does not make any remittances to X in 2022, so the offsetting gain with respect to the loan receivable has not been recognized by X.

(ii) *Analysis.* Y, a related party to X, and Business A have offsetting positions in the euro. The IRS will scrutinize the transaction under paragraph (b)(3) of this section to determine whether a principal purpose of recording the euro-denominated receivable on the books and records of Business A, rather than on the books and records of X, was to avoid tax through the use of section 987. If such a principal purpose is present, the IRS may reallocate the euro-denominated receivable between Business A and X under paragraph (c)(7) of this section to reflect the substance of the transaction. Other provisions may also apply to defer or disallow the loss.

Example 16. Loan by section 987 QBU followed by immediate distribution to owner. (i) *Facts.* X owns all of the interests in DE1. DE1 owns Business A. On January 1, 2021, Business A borrows €1,000 from a bank. On January 2, 2021, Business A distributes the €1,000 it received from the bank to X. There are no other transfers between X and Business A during the year. At the end of the year, X has net unrecognized section 987 loss with respect to Business A such that a remittance would result in the recognition of foreign currency loss under section 987.

(ii) *Analysis.* Because the proceeds from the loan to Business A are immediately transferred to X and the distribution from Business A to X could result in the recognition of section 987 loss, the IRS may scrutinize the recording of the loan on the books of Business A and move the loan onto the books of X, resulting in the transfer not being taken into account for purposes of section 987 under paragraph (b)(3) of this section.

Example 17. Payment of interest by section 987 QBU on obligation of owner. (i) *Facts.* X owns all of the interests in DE1. DE1 owns business A. On January 1, X borrows €1,000 from a bank. On July 1, Business A pays €20 in interest on X's €1,000 obligation to the bank.

(ii) *Analysis.* Under general tax law principles as provided in paragraph (c)(7) of this section, on July 1, 2021, Business A is treated for purposes of section 987 as making a transfer of €20 to X, and X is treated as making a €20 interest payment to the bank.

(d) *Translation of items transferred to a section 987 QBU*—(1) *Marked items.* The adjusted basis of a marked asset, or the amount of a marked liability, transferred to a section 987 QBU shall be translated into the section 987 QBU's functional currency at the spot rate (as defined in §1.987–1(c)(1)) applicable to the date of transfer. If the asset or liability transferred is denominated in (or determined by reference to) the functional currency of the section 987

QBU (for example, cash or a note denominated in the functional currency of the section 987 QBU), no translation is required. See §1.988–1(a)(10)(ii) for special rules regarding intra-taxpayer transfers.

(2) *Historic items.* The adjusted basis of a historic asset, or the amount of a historic liability, transferred to a section 987 QBU shall be translated into the section 987 QBU's functional currency at the rate provided in §1.987–1(c)(3).

[T.D. 9794, 81 FR 88821, Dec. 8, 2016, as amended by T.D. 9795, 81 FR 88870, Dec. 8, 2016]

§ 1.987–2T Attribution of items to eligible QBUs; definition of a transfer and related rules (temporary).

(a) through (c)(8) [Reserved]. For further guidance, see §1.987–2(a) through (c)(8).

(9) *Certain disregarded transactions not treated as transfers*—(i) *Combinations of section 987 QBUs.* The combination of two or more separate section 987 QBUs (combining QBUs) that are directly owned by the same owner, or that are indirectly owned by the same partner through a single section 987 aggregate partnership, into one section 987 QBU (combined QBU) does not give rise to a transfer of any combining QBU's assets or liabilities to the owner under §1.987–2(c). In addition, transactions between the combining QBUs occurring in the taxable year of the combination do not result in a transfer of the combining QBUs' assets or liabilities to the owner under §1.987–2(c). For this purpose, a combination occurs when the assets and liabilities that are properly reflected on the books and records of two or more combining QBUs begin to be properly reflected on the books and records of a combined QBU and the separate existence of the combining QBUs ceases. A combination may result from any transaction or series of transactions in which the combining QBUs become a combined QBU. For rules regarding the determination of net unrecognized section 987 gain or loss of a combined QBU, see §1.987–4T(f)(1).

(ii) *Change in functional currency from a combination.* If, following a combination of section 987 QBUs described in paragraph (c)(9)(i) of this section, the combined section 987 QBU has a different functional currency than one or more of the combining section 987 QBUs, any such combining section 987 QBU is treated as changing its functional currency and the owner of the combined section 987 QBU must comply with the regulations under section 985 regarding the change in functional currency. See §§1.985–1(c)(6) and 1.985–5.

(iii) *Separation of section 987 QBUs.* The separation of a section 987 QBU (separating QBU) into two or more section 987 QBUs (separated QBUs) that, after the separation, are directly owned by the same owner, or that are indirectly owned by the same partner through a single section 987 aggregate partnership, does not give rise to a transfer of the separating QBU's assets or liabilities to the owner under §1.987–2(c). Additionally, transactions that occurred between the separating QBUs in the taxable year of the separation prior to the completion of the separation do not give rise to transfers for purposes of section 987. For this purpose, a separation occurs when the assets and liabilities that are properly reflected on the books and records of a separating QBU begin to be properly reflected on the books and records of two or more separated QBUs. A separation may result from any transaction or series of transactions in which a separating QBU becomes two or more separated QBUs. A separation may also result when a section 987 QBU that is subject to a grouping election under §1.987–1(b)(2)(ii)(A) changes its functional currency. For rules regarding the determination of net unrecognized section 987 gain or loss of a separated QBU, see §1.987–4T(f)(2).

(c)(10) through (d) [Reserved]. For further guidance see §1.987–2(c)(10) through (d).

(e) *Effective/applicability date.* This section applies to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. Notwithstanding the preceding sentence, if a taxpayer makes an election under §1.987–11(b), then this section applies to taxable years to which §§1.987–1 through 1.987–10 apply as a result of such election.