AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

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.

(1) In general.
(2) Description of transactions.
(3) [Reserved]
(4) Treatment of assets and liabilities of a section 987 aggregate partnership or DE that are not attributed to an eligible QBU.
(5) [Reserved]
(6) Examples.
(7) Special rules for regulated futures contracts and non-equity options.
(8) Special rules for qualified funds.
(9) Exception for certain transactions entered into by an individual.
(10) Intra-taxpayer transactions.
(11) Authority of Commissioner to include or exclude transactions from section 988.
(b) Spot contract.
(c) Nonfunctional currency.
(d) Spot rate.
(1) In general.
(2) Consistency required in valuing transactions subject to section 988.
(3) Use of certain spot rate conventions for payables and receivables denominated in nonfunctional currency.
(4) Currency where an official government established rate differs from a free market rate.
(e) Exchange gain or loss.
(f) Hyperinflationary currency.
(g) Fair market value.
(h) Interaction with sections 1092 and 1256 in examples.
(i) Effective date.

§ 1.988–2 Recognition and computation of exchange gain or loss.

(a) Disposition of nonfunctional currency.
(1) Recognition of exchange gain or loss.
(2) Computation of exchange gain or loss.
(b) Translation of interest income or expense and determination of exchange gain or loss with respect to debt instruments.
(1) Translation of interest income received with respect to a nonfunctional currency demand account.
(2) Translation of nonfunctional currency interest income or expense received or paid with respect to a debt instrument described in § 1.988–1(a)(1)(ii) and (2)(i).
(3) Exchange gain or loss recognized by the holder with respect to accrued interest income.
(4) Exchange gain or loss recognized by the obligor with respect to accrued interest expense.
(5) Exchange gain or loss recognized by the holder of a debt instrument with respect to principal.
(6) Exchange gain or loss recognized by the obligor of a debt instrument with respect to principal.
(7) Payment ordering rules.
(8) Limitation of exchange gain or loss on payment or disposition of a debt instrument.
(9) Examples.
(10) Treatment of bond premium.
(11) Market discount.
(12) Tax exempt bonds.
(13) Nonfunctional currency debt exchanged for stock of obligor.
(14) [Reserved]
(15) Debt instruments and deposits denominated in hyperinflationary currencies.
(16) [Reserved]
(17) Coordination with installment method under section 453.
(18) Interaction of section 988 and § 1.1275–2(g).
(c) Item of expense or gross income or receipts which is to be paid or received after the date accrued.
(1) In general.
(2) Determination of exchange gain or loss with respect to an item of gross income or receipts.
(3) Determination of exchange gain or loss with respect to an item of expense.
(4) Examples.
(d) Exchange gain or loss with respect to forward contracts, futures contracts and option contracts.
(1) Scope.
(2) Realization of exchange gain or loss.
(3) Recognition of exchange gain or loss.
(4) Determination of exchange gain or loss.
(5) Hyperinflationary contracts.
(e) Currency swaps and notional principal contracts.
(1) Notional principal contract denominated in a single nonfunctional currency.
(2) Special rules for currency swaps.
(3) Amortization of swap premium or discount in the case of off market swaps.
(4) Treatment of taxpayer disposing of a currency swap.
(5) Examples.
(6) Special effective date for rules regarding currency swaps.
(7) Special rules for currency swap contracts in hyperinflationary currencies.
(f) Substance over form.
(1) In general.
(2) Example.
(g) Effective date.
(h) Timing of income and deductions from notional principal contracts.
(i) [Reserved]

§ 1.988–3 Character of exchange gain or loss.

(a) In general.
(b) Election to characterize exchange gain or loss on certain identified forward contracts, futures contracts and option contracts as capital gain or loss.
(1) In general.
(2) Special rule for contracts that become part of a straddle after the election is made.
(3) Requirements for making the election.
(4) Verification.
(5) Independent verification.
(6) Effective date.
(c) Exchange gain or loss treated as interest.

(1) In general.
(2) Exchange loss realized by the holder on nonfunctional currency tax exempt bonds.
(d) Effective date.

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

(a) In general.
(b) Qualified business unit.
(1) In general.
(2) Proper reflection on the books of the taxpayer or qualified business unit.
(c) Effectively connected exchange gain or loss.
(d) Residence.
(1) In general.
(2) Exception.
(3) Partner in a partnership not engaged in a U.S. trade or business under section 864(b)(2).
(e) Special rule for certain related party loans.
(1) In general.
(2) United States person.
(3) Loans by related person.
(4) 10 percent owned foreign corporation.
(f) Exchange gain or loss treated as interest under §1.988–3.
(g) Exchange gain or loss allocated in the same manner as interest under §1.861–9T.
(h) Effective date.

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

(a) Integration of a nonfunctional currency debt instrument and a §1.988–5(a) hedge.
(1) In general.
(2) Exception.
(3) Qualifying debt instrument.
(4) Section 1.988–5(a) hedge.
(5) Definition of integrated economic transaction.
(6) Special rules for legging in and legging out of integrated treatment.
(7) Transactions part of a straddle.
(8) Identification requirements.
(9) Taxation of qualified hedging transactions.
(10) Transition rules and effective dates.
(b) Hedged executory contracts.
(1) In general.
(2) Definitions.
(3) Identification rules.
(4) Effect of hedged executory contract.
(5) References to this paragraph (b).
(c) Hedges of period between trade date and settlement date on purchase or sale of publicly traded stock or security.
(d) [Reserved]
(e) Advance rulings regarding net hedging and anticipatory hedging systems.
(f) [Reserved]
(g) General effective date.

§ 1.988–6 Nonfunctional Currency Contingent Payment Debt Instruments

(a) In general.
(1) Scope.
(2) Exception for hyperinflationary currencies.
(b) Instruments described in paragraph (a)(1)(i) of this section.
(1) In general.
(2) Application of noncontingent bond method.
(3) Treatment and translation of amounts determined under noncontingent bond method.
(4) Determination of gain or loss not attributable to foreign currency.
(5) Determination of foreign currency gain or loss.
(6) Source of gain or loss.
(7) Basis different from adjusted issue price.
(8) Fixed but deferred contingent payments.
(c) Examples.
(d) Multicurrency debt instruments.
(1) In general.
(2) Determination of denomination currency.
(3) Issuer/holder consistency.
(4) Treatment of payments in currencies other than the denomination currency.
(e) Instruments issued for nonpublicly traded property.
(1) Applicability.
(2) Separation into components.
(3) Treatment of components consisting of one or more noncontingent payments in the same currency.
(4) Treatment of components consisting of contingent payments.
(5) Basis different from adjusted issue price.
(6) Treatment of holder on sale, exchange, or retirement.
(f) Rules for nonfunctional currency tax exempt obligations described in §1.1275–4(d).
(g) Effective date.

[T.D. 8400, 57 FR 9177, Mar. 17, 1992, as amended by T.D. 8860, 65 FR 2028, Jan. 13, 2000; T.D. 9157, 69 FR 52818, Aug. 30, 2004; T.D. 9794, 81 FR 88850, Dec. 8, 2016; T.D. 9795, 81 FR 88879, Dec. 8, 2016]

§ 1.988–1 Certain definitions and special rules.

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

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

(ii) Any transaction described in paragraph (a)(2) of this section if any amount which the taxpayer is entitled to receive or is required to pay by reason of such transaction is denominated