

(A) such unit keeps its books and records in dollars, or

(B) the taxpayer uses a method of accounting that approximates a separate transactions method.

Any such election shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

**(4) Change in functional currency treated as a change in method of accounting**

Any change in the functional currency shall be treated as a change in the taxpayer's method of accounting for purposes of section 481 under procedures to be established by the Secretary.

(Added Pub. L. 99-514, title XII, §1261(a), Oct. 22, 1986, 100 Stat. 2585.)

**Statutory Notes and Related Subsidiaries**

**EFFECTIVE DATE**

Pub. L. 99-514, title XII, §1261(e), Oct. 22, 1986, 100 Stat. 2591, provided that:

“(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section [enacting this subpart and amending sections 1092 and 1256 of this title] shall apply to taxable years beginning after December 31, 1986.

“(2) SPECIAL RULES FOR PURPOSES OF SECTIONS 902 AND 960.—For purposes of applying sections [former] 902 and 960 of the Internal Revenue Code of 1986, the amendments made by this section shall apply to—

“(A) earnings and profits of the foreign corporation for taxable years beginning after December 31, 1986, and

“(B) foreign taxes paid or accrued by the foreign corporation with respect to such earnings and profits.”

**§ 986. Determination of foreign taxes and foreign corporation's earnings and profits**

**(a) Foreign income taxes**

**(1) Translation of accrued taxes**

**(A) In general**

For purposes of determining the amount of the foreign tax credit, in the case of a taxpayer who takes foreign income taxes into account when accrued, the amount of any foreign income taxes (and any adjustment thereto) shall be translated into dollars by using the average exchange rate for the taxable year to which such taxes relate.

**(B) Exception for certain taxes**

Subparagraph (A) shall not apply to any foreign income taxes—

(i) paid after the date 2 years after the close of the taxable year to which such taxes relate, or

(ii) paid before the beginning of the taxable year to which such taxes relate.

**(C) Exception for inflationary currencies**

Subparagraph (A) shall not apply to any foreign income taxes the liability for which is denominated in any inflationary currency (as determined under regulations).

**(D) Elective exception for taxes paid other than in functional currency**

**(i) In general**

At the election of the taxpayer, subparagraph (A) shall not apply to any foreign in-

come taxes the liability for which is denominated in any currency other than in the taxpayer's functional currency.

**(ii) Application to qualified business units**

An election under this subparagraph may apply to foreign income taxes attributable to a qualified business unit in accordance with regulations prescribed by the Secretary.

**(iii) Election**

Any such election shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

**(E) Special rule for regulated investment companies**

In the case of a regulated investment company which takes into account income on an accrual basis, subparagraphs (A) through (D) shall not apply and foreign income taxes paid or accrued with respect to such income shall be translated into dollars using the exchange rate as of the date the income accrues.

**(F) Cross reference**

**For adjustments where tax is not paid within 2 years, see section 905(c).**

**(2) Translation of taxes to which paragraph (1) does not apply**

For purposes of determining the amount of the foreign tax credit, in the case of any foreign income taxes to which subparagraph (A) or (E) of paragraph (1) does not apply—

(A) such taxes shall be translated into dollars using the exchange rates as of the time such taxes were paid to the foreign country or possession of the United States, and

(B) any adjustment to the amount of such taxes shall be translated into dollars using—

(i) except as provided in clause (ii), the exchange rate as of the time when such adjustment is paid to the foreign country or possession, or

(ii) in the case of any refund or credit of foreign income taxes, using the exchange rate as of the time of the original payment of such foreign income taxes.

**(3) Authority to permit use of average rates**

To the extent prescribed in regulations, the average exchange rate for the period (specified in such regulations) during which the taxes or adjustment is paid may be used instead of the exchange rate as of the time of such payment.

**(4) Foreign income taxes**

For purposes of this subsection, the term “foreign income taxes” means any income, war profits, or excess profits taxes paid or accrued to any foreign country or to any possession of the United States.

**(b) Earnings and profits and distributions**

For purposes of determining the tax under this subtitle—

(1) of any shareholder of any foreign corporation, the earnings and profits of such corporation shall be determined in the corporation's functional currency, and

(2) in the case of any United States person, the earnings and profits determined under paragraph (1) (when distributed, deemed distributed, or otherwise taken into account under this subtitle) shall (if necessary) be translated into dollars using the appropriate exchange rate.

**(c) Previously taxed earnings and profits**

**(1) In general**

Foreign currency gain or loss with respect to distributions of previously taxed earnings and profits (as described in section 959 or 1293(c)) attributable to movements in exchange rates between the times of deemed and actual distribution shall be recognized and treated as ordinary income or loss from the same source as the associated income inclusion.

**(2) Distributions through tiers**

The Secretary shall prescribe regulations with respect to the treatment of distributions of previously taxed earnings and profits through tiers of foreign corporations.

(Added Pub. L. 99-514, title XII, §1261(a), Oct. 22, 1986, 100 Stat. 2586; amended Pub. L. 100-647, title I, §1012(v)(1)(A), Nov. 10, 1988, 102 Stat. 3528; Pub. L. 105-34, title XI, §1102(a)(1), (b)(1), Aug. 5, 1997, 111 Stat. 963, 965; Pub. L. 108-357, title IV, §408(a), (b), Oct. 22, 2004, 118 Stat. 1499.)

**Editorial Notes**

AMENDMENTS

2004—Subsec. (a)(1)(D). Pub. L. 108-357, §408(a), added subpar. (D). Former subpar. (D) redesignated (E).

Subsec. (a)(1)(E). Pub. L. 108-357, §408(b)(1), added subpar. (E). Former subpar. (E) redesignated (F).

Pub. L. 108-357, §408(a), redesignated subpar. (D) as (E).

Subsec. (a)(1)(F). Pub. L. 108-357, §408(b)(1), redesignated subpar. (E) as (F).

Subsec. (a)(2). Pub. L. 108-357, §408(b)(2), inserted “or (E)” after “subparagraph (A)” in introductory provisions.

1997—Subsec. (a). Pub. L. 105-34, §1102(a)(1), amended subsec. (a) generally. Prior to amendment, subsec. (a) read as follows:

“(a) FOREIGN TAXES.—

“(1) IN GENERAL.—For purposes of determining the amount of the foreign tax credit—

“(A) any foreign income taxes shall be translated into dollars using the exchange rates as of the time such taxes were paid to the foreign country or possession of the United States, and

“(B) any adjustment to the amount of foreign income taxes shall be translated into dollars using—

“(i) except as provided in clause (ii), the exchange rate as of the time when such adjustment is paid to the foreign country or possession, or

“(ii) in the case of any refund or credit of foreign income taxes, using the exchange rate as of the time of original payment of such foreign income taxes.

“(2) FOREIGN INCOME TAXES.—For purposes of paragraph (1), ‘foreign income taxes’ means any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States.”

Subsec. (a)(3), (4). Pub. L. 105-34, §1102(b)(1), added par. (3) and redesignated former par. (3) as (4).

1988—Pub. L. 100-647 substituted “foreign taxes and foreign corporation’s earnings and profits” for “foreign corporation’s earnings and profits and foreign taxes” in heading, and revised and restructured the provisions of subsecs. (a) and (b).

**Statutory Notes and Related Subsidiaries**

EFFECTIVE DATE OF 2004 AMENDMENT

Pub. L. 108-357, title IV, §408(c), Oct. 22, 2004, 118 Stat. 1500, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 2004.”

EFFECTIVE DATE OF 1997 AMENDMENT

Pub. L. 105-34, title XI, §1102(c)(1), Aug. 5, 1997, 111 Stat. 966, provided that: “The amendments made by subsections (a)(1) and (b) [amending this section and section 989 of this title] shall apply to taxes paid or accrued in taxable years beginning after December 31, 1997.”

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1986, with certain exceptions and qualifications, see section 1261(e) of Pub. L. 99-514, set out as a note under section 985 of this title.

**§ 987. Branch transactions**

In the case of any taxpayer having 1 or more qualified business units with a functional currency other than the dollar, taxable income of such taxpayer shall be determined—

(1) by computing the taxable income or loss separately for each such unit in its functional currency,

(2) by translating the income or loss separately computed under paragraph (1) at the appropriate exchange rate, and

(3) by making proper adjustments (as prescribed by the Secretary) for transfers of property between qualified business units of the taxpayer having different functional currencies, including—

(A) treating post-1986 remittances from each such unit as made on a pro rata basis out of post-1986 accumulated earnings, and

(B) treating gain or loss determined under this paragraph as ordinary income or loss, respectively, and sourcing such gain or loss by reference to the source of the income giving rise to post-1986 accumulated earnings.

(Added Pub. L. 99-514, title XII, §1261(a), Oct. 22, 1986, 100 Stat. 2586; amended Pub. L. 100-647, title I, §1012(v)(1)(B), Nov. 10, 1988, 102 Stat. 3528.)

**Editorial Notes**

AMENDMENTS

1988—Par. (4). Pub. L. 100-647 struck out par. (4) which provided for translation of foreign income taxes paid by each qualified business unit of the taxpayer in the same manner as provided under section 986(b).

**Statutory Notes and Related Subsidiaries**

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.