

## 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.

**§ 988. Treatment of certain foreign currency transactions**

**(a) General rule**

Notwithstanding any other provision of this chapter—

**(1) Treatment as ordinary income or loss**

**(A) In general**

Except as otherwise provided in this section, any foreign currency gain or loss attributable to a section 988 transaction shall be computed separately and treated as ordinary income or loss (as the case may be).

**(B) Special rule for forward contracts, etc.**

Except as provided in regulations, a taxpayer may elect to treat any foreign currency gain or loss attributable to a forward contract, a futures contract, or option described in subsection (c)(1)(B)(iii) which is a capital asset in the hands of the taxpayer and which is not a part of a straddle (within the meaning of section 1092(c), without regard to paragraph (4) thereof) as capital gain or loss (as the case may be) if the taxpayer makes such election and identifies such transaction before the close of the day on which such transaction is entered into (or such earlier time as the Secretary may prescribe).

**(2) Gain or loss treated as interest for certain purposes**

To the extent provided in regulations, any amount treated as ordinary income or loss under paragraph (1) shall be treated as interest income or expense (as the case may be).

**(3) Source**

**(A) In general**

Except as otherwise provided in regulations, in the case of any amount treated as ordinary income or loss under paragraph (1) (without regard to paragraph (1)(B)), the source of such amount shall be determined by reference to the residence of the taxpayer or the qualified business unit of the taxpayer on whose books the asset, liability, or item of income or expense is properly reflected.

**(B) Residence**

For purposes of this subpart—

**(i) In general**

The residence of any person shall be—

(I) in the case of an individual, the country in which such individual's tax home (as defined in section 911(d)(3)) is located,

(II) in the case of any corporation, partnership, trust, or estate which is a United States person (as defined in section 7701(a)(30)), the United States, and

(III) in the case of any corporation, partnership, trust, or estate which is not

a United States person, a country other than the United States.

If an individual does not have a tax home (as so defined), the residence of such individual shall be the United States if such individual is a United States citizen or a resident alien and shall be a country other than the United States if such individual is not a United States citizen or a resident alien.

**(ii) Exception**

In the case of a qualified business unit of any taxpayer (including an individual), the residence of such unit shall be the country in which the principal place of business of such qualified business unit is located.

**(iii) Special rule for partnerships**

To the extent provided in regulations, in the case of a partnership, the determination of residence shall be made at the partner level.

**(C) Special rule for certain related party loans**

Except to the extent provided in regulations, in the case of a loan by a United States person or a related person to a 10-percent owned foreign corporation which is denominated in a currency other than the dollar and bears interest at a rate at least 10 percentage points higher than the Federal mid-term rate (determined under section 1274(d)) at the time such loan is entered into, the following rules shall apply:

(i) For purposes of section 904 only, such loan shall be marked to market on an annual basis.

(ii) Any interest income earned with respect to such loan for the taxable year shall be treated as income from sources within the United States to the extent of any loss attributable to clause (i).

For purposes of this subparagraph, the term "related person" has the meaning given such term by section 954(d)(3), except that such section shall be applied by substituting "United States person" for "controlled foreign corporation" each place such term appears.

**(D) 10-percent owned foreign corporation**

The term "10-percent owned foreign corporation" means any foreign corporation in which the United States person owns directly or indirectly at least 10 percent of the voting stock.

**(b) Foreign currency gain or loss**

For purposes of this section—

**(1) Foreign currency gain**

The term "foreign currency gain" means any gain from a section 988 transaction to the extent such gain does not exceed gain realized by reason of changes in exchange rates on or after the booking date and before the payment date.

**(2) Foreign currency loss**

The term "foreign currency loss" means any loss from a section 988 transaction to the ex-

tent such loss does not exceed the loss realized by reason of changes in exchange rates on or after the booking date and before the payment date.

**(3) Special rule for certain contracts, etc.**

In the case of any section 988 transaction described in subsection (c)(1)(B)(iii), any gain or loss from such transaction shall be treated as foreign currency gain or loss (as the case may be).

**(c) Other definitions**

For purposes of this section—

**(1) Section 988 transaction**

**(A) In general**

The term “section 988 transaction” means any transaction described in subparagraph (B) if the amount which the taxpayer is entitled to receive (or is required to pay) by reason of such transaction—

- (i) is denominated in terms of a nonfunctional currency, or
- (ii) is determined by reference to the value of 1 or more nonfunctional currencies.

**(B) Description of transactions**

For purposes of subparagraph (A), the following transactions are described in this subparagraph:

- (i) The acquisition of a debt instrument or becoming the obligor under a debt instrument.
- (ii) Accruing (or otherwise taking into account) for purposes of this subtitle any item of expense or gross income or receipts which is to be paid or received after the date on which so accrued or taken into account.
- (iii) Entering into or acquiring any forward contract, futures contract, option, or similar financial instrument.

The Secretary may prescribe regulations excluding from the application of clause (ii) any class of items the taking into account of which is not necessary to carry out the purposes of this section by reason of the small amounts or short periods involved, or otherwise.

**(C) Special rules for disposition of nonfunctional currency**

**(i) In general**

In the case of any disposition of any nonfunctional currency—

- (I) such disposition shall be treated as a section 988 transaction, and
- (II) any gain or loss from such transaction shall be treated as foreign currency gain or loss (as the case may be).

**(ii) Nonfunctional currency**

For purposes of this section, the term “nonfunctional currency” includes coin or currency, and nonfunctional currency denominated demand or time deposits or similar instruments issued by a bank or other financial institution.

**(D) Exception for certain instruments marked to market**

**(i) In general**

Clause (iii) of subparagraph (B) shall not apply to any regulated futures contract or nonequity option which would be marked to market under section 1256 if held on the last day of the taxable year.

**(ii) Election out**

**(I) In general**

The taxpayer may elect to have clause (i) not apply to such taxpayer. Such an election shall apply to contracts held at any time during the taxable year for which such election is made or any succeeding taxable year unless such election is revoked with the consent of the Secretary.

**(II) Time for making election**

Except as provided in regulations, an election under subclause (I) for any taxable year shall be made on or before the 1st day of such taxable year (or, if later, on or before the 1st day during such year on which the taxpayer holds a contract described in clause (i)).

**(III) Special rule for partnerships, etc.**

In the case of a partnership, an election under subclause (I) shall be made by each partner separately. A similar rule shall apply in the case of an S corporation.

**(iii) Treatment of certain partnerships**

This subparagraph shall not apply to any income or loss of a partnership for any taxable year if such partnership made an election under subparagraph (E)(iii)(V) for such year or any preceding year.

**(E) Special rules for certain funds**

**(i) In general**

In the case of a qualified fund, clause (iii) of subparagraph (B) shall not apply to any instrument which would be marked to market under section 1256 if held on the last day of the taxable year (determined after the application of clause (iv)).

**(ii) Special rule where electing partnership does not qualify**

If any partnership made an election under clause (iii)(V) for any taxable year and such partnership has a net loss for such year or any succeeding year from instruments referred to in clause (i), the rules of clauses (i) and (iv) shall apply to any such loss year whether or not such partnership is a qualified fund for such year.

**(iii) Qualified fund defined**

For purposes of this subparagraph, the term “qualified fund” means any partnership if—

- (I) at all times during the taxable year (and during each preceding taxable year to which an election under subclause (V) applied), such partnership has at least 20

partners and no single partner owns more than 20 percent of the interests in the capital or profits of the partnership.

(II) the principal activity of such partnership for such taxable year (and each such preceding taxable year) consists of buying and selling options, futures, or forwards with respect to commodities,

(III) at least 90 percent of the gross income of the partnership for the taxable year (and for each such preceding taxable year) consisted of income or gains described in subparagraph (A), (B), or (G) of section 7704(d)(1) or gain from the sale or disposition of capital assets held for the production of interest or dividends,

(IV) no more than a de minimis amount of the gross income of the partnership for the taxable year (and each such preceding taxable year) was derived from buying and selling commodities, and

(V) an election under this subclause applies to the taxable year.

An election under subclause (V) for any taxable year shall be made on or before the 1st day of such taxable year (or, if later, on or before the 1st day during such year on which the partnership holds an instrument referred to in clause (i)). Any such election shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary.

**(iv) Treatment of certain currency contracts**

**(I) In general**

Except as provided in regulations, in the case of a qualified fund, any bank forward contract, any foreign currency futures contract traded on a foreign exchange, or to the extent provided in regulations any similar instrument, which is not otherwise a section 1256 contract shall be treated as a section 1256 contract for purposes of section 1256.

**(II) Gains and losses treated as short-term**

In the case of any instrument treated as a section 1256 contract under subclause (I), subparagraph (A) of section 1256(a)(3) shall be applied by substituting "100 percent" for "40 percent" (and subparagraph (B) of such section shall not apply).

**(v) Special rules for clause (iii)(I)**

**(I) Certain general partners**

The interest of a general partner in the partnership shall not be treated as failing to meet the 20-percent ownership requirements of clause (iii)(I) for any taxable year of the partnership if, for the taxable year of the partner in which such partnership taxable year ends, such partner (and each corporation filing a consolidated return with such partner) had no ordinary income or loss from a section 988 transaction which is foreign currency gain or loss (as the case may be).

**(II) Treatment of incentive compensation**

For purposes of clause (iii)(I), any income allocable to a general partner as incentive compensation based on profits rather than capital shall not be taken into account in determining such partner's interest in the profits of the partnership.

**(III) Treatment of tax-exempt partners**

Except as provided in regulations, the interest of a partner in the partnership shall not be treated as failing to meet the 20-percent ownership requirements of clause (iii)(I) if none of the income of such partner from such partnership is subject to tax under this chapter (whether directly or through 1 or more pass-thru entities).

**(IV) Look-thru rule**

In determining whether the requirements of clause (iii)(I) are met with respect to any partnership, except to the extent provided in regulations, any interest in such partnership held by another partnership shall be treated as held proportionately by the partners in such other partnership.

**(vi) Other special rules**

For purposes of this subparagraph—

**(I) Related persons**

Interests in the partnership held by persons related to each other (within the meaning of sections 267(b) and 707(b)) shall be treated as held by 1 person.

**(II) Predecessors**

References to any partnership shall include a reference to any predecessor thereof.

**(III) Inadvertent terminations**

Rules similar to the rules of section 7704(e) shall apply.

**(IV) Treatment of certain debt instruments**

For purposes of clause (iii)(IV), any debt instrument which is a section 988 transaction shall be treated as a commodity.

**(2) Booking date**

The term "booking date" means—

(A) in the case of a transaction described in paragraph (1)(B)(i), the date of acquisition or on which the taxpayer becomes the obligor, or

(B) in the case of a transaction described in paragraph (1)(B)(ii), the date on which accrued or otherwise taken into account.

**(3) Payment date**

The term "payment date" means the date on which the payment is made or received.

**(4) Debt instrument**

The term "debt instrument" means a bond, debenture, note, or certificate or other evidence of indebtedness. To the extent provided in regulations, such term shall include preferred stock.

**(5) Special rules where taxpayer takes or makes delivery**

If the taxpayer takes or makes delivery in connection with any section 988 transaction described in paragraph (1)(B)(iii), any gain or loss (determined as if the taxpayer sold the contract, option, or instrument on the date on which he took or made delivery for its fair market value on such date) shall be recognized in the same manner as if such contract, option, or instrument were so sold.

**(d) Treatment of 988 hedging transactions**

**(1) In general**

To the extent provided in regulations, if any section 988 transaction is part of a 988 hedging transaction, all transactions which are part of such 988 hedging transaction shall be integrated and treated as a single transaction or otherwise treated consistently for purposes of this subtitle. For purposes of the preceding sentence, the determination of whether any transaction is a section 988 transaction shall be determined without regard to whether such transaction would otherwise be marked-to-market under section 475 or 1256 and such term shall not include any transaction with respect to which an election is made under subsection (a)(1)(B). Sections 475, 1092, and 1256 shall not apply to a transaction covered by this subsection.

**(2) 988 hedging transaction**

For purposes of paragraph (1), the term “988 hedging transaction” means any transaction—

(A) entered into by the taxpayer primarily—

(i) to manage risk of currency fluctuations with respect to property which is held or to be held by the taxpayer, or

(ii) to manage risk of currency fluctuations with respect to borrowings made or to be made, or obligations incurred or to be incurred, by the taxpayer, and

(B) identified by the Secretary or the taxpayer as being a 988 hedging transaction.

**(e) Application to individuals**

**(1) In general**

The preceding provisions of this section shall not apply to any section 988 transaction entered into by an individual which is a personal transaction.

**(2) Exclusion for certain personal transactions**

If—

(A) nonfunctional currency is disposed of by an individual in any transaction, and

(B) such transaction is a personal transaction,

no gain shall be recognized for purposes of this subtitle by reason of changes in exchange rates after such currency was acquired by such individual and before such disposition. The preceding sentence shall not apply if the gain which would otherwise be recognized on the transaction exceeds \$200.

**(3) Personal transactions**

For purposes of this subsection, the term “personal transaction” means any transaction

entered into by an individual, except that such term shall not include any transaction to the extent that expenses properly allocable to such transaction meet the requirements of—

(A) section 162 (other than traveling expenses described in subsection (a)(2) thereof), or

(B) section 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes).

(Added Pub. L. 99-514, title XII, §1261(a), Oct. 22, 1986, 100 Stat. 2587; amended Pub. L. 100-647, title I, §1012(v)(2)(A), (3), (4), (6)-(8), title VI, §6130(a), (b), Nov. 10, 1988, 102 Stat. 3529, 3530, 3717; Pub. L. 101-239, title VII, §7811(i)(7), Dec. 19, 1989, 103 Stat. 2410; Pub. L. 103-66, title XIII, §13223(b)(1), Aug. 10, 1993, 107 Stat. 484; Pub. L. 105-34, title XI, §1104(a), Aug. 5, 1997, 111 Stat. 967; Pub. L. 106-170, title V, §532(b)(3), Dec. 17, 1999, 113 Stat. 1930.)

**Editorial Notes**

AMENDMENTS

1999—Subsec. (d)(2)(A)(i), (ii). Pub. L. 106-170 substituted “to manage” for “to reduce”.

1997—Subsec. (e). Pub. L. 105-34 amended heading and text of subsec. (e) generally. Prior to amendment, text read as follows: “This section shall apply to section 988 transactions entered into by an individual only to the extent expenses properly allocable to such transactions meet the requirements of section 162 or 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes).”

1993—Subsec. (d)(1). Pub. L. 103-66 substituted “section 475 or 1256” for “section 1256” and “Sections 475, 1092, and 1256” for “Sections 1092 and 1256”.

1989—Subsec. (a). Pub. L. 101-239 inserted introductory provision “Notwithstanding any other provision of this chapter—”.

1988—Subsec. (a)(3)(B)(i). Pub. L. 100-647, §1012(v)(8), inserted at end “If an individual does not have a tax home (as so defined), the residence of such individual shall be the United States if such individual is a United States citizen or a resident alien and shall be a country other than the United States if such individual is not a United States citizen or a resident alien.”

Subsec. (a)(3)(B)(iii). Pub. L. 100-647, §1012(v)(7), added cl. (iii).

Subsec. (b)(3). Pub. L. 100-647, §1012(v)(3)(A), added par. (3).

Subsec. (c)(1)(B)(iii). Pub. L. 100-647, §6130(a), struck out “unless such instrument would be marked to market under section 1256 if held on the last day of the taxable year” after “similar financial instrument”.

Pub. L. 100-647, §1012(v)(6), amended cl. (iii) generally. Prior to amendment, cl. (iii) read as follows: “Entering into or acquiring any forward contract, futures contract, option, or similar financial instrument if such instrument is not marked to market at the close of the taxable year under section 1256.”

Subsec. (c)(1)(C)(i)(II). Pub. L. 100-647, §1012(v)(3)(B), amended subcl. (II) generally. Prior to amendment, subcl. (II) read as follows: “for purposes of determining the foreign currency gain or loss from such transaction, paragraphs (1) and (2) of subsection (b) shall be applied by substituting ‘acquisition date’ for ‘booking date’ and ‘disposition’ for ‘payment date’.”

Subsec. (c)(1)(D), (E). Pub. L. 100-647, §6130(b), added subpars. (D) and (E).

Subsec. (c)(2)(C). Pub. L. 100-647, §1012(v)(3)(C), struck out subpar. (C) which defined “booking date” in the case of a transaction described in par. (1)(B)(iii) as the date on which the position is entered into or acquired.

Subsec. (c)(3). Pub. L. 100-647, §1012(v)(3)(D), amended par. (3) generally. Prior to amendment, par. (3) read as follows: “The term ‘payment date’ means—

“(A) in the case of a transaction described in paragraph (1)(B)(i) or (ii), the date on which payment is made or received, or

“(B) in the case of a transaction described in paragraph (1)(B)(iii), the date payment is made or received or the date the taxpayer’s rights with respect to the position are terminated.”

Subsec. (c)(5). Pub. L. 100-647, §1012(v)(2)(A), added par. (5).

Subsec. (d)(1). Pub. L. 100-647, §1012(v)(4), substituted “this subtitle” for “this section”.

### Statutory Notes and Related Subsidiaries

#### EFFECTIVE DATE OF 1999 AMENDMENT

Amendment by Pub. L. 106-170 applicable to any instrument held, acquired, or entered into, any transaction entered into, and supplies held or acquired on or after Dec. 17, 1999, see section 532(d) of Pub. L. 106-170, set out as a note under section 170 of this title.

#### EFFECTIVE DATE OF 1997 AMENDMENT

Pub. L. 105-34, title XI, §1104(b), Aug. 5, 1997, 111 Stat. 967, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 1997.”

#### EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103-66 applicable to all taxable years ending on or after Dec. 31, 1993, with special rules for taxpayers required to change accounting methods and for floor specialists and market makers, see section 13223(c) of Pub. L. 103-66, set out as an Effective Date note under section 475 of this title.

#### EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101-239 effective, except as otherwise provided, as if included in the provision of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100-647, to which such amendment relates, see section 7817 of Pub. L. 101-239, set out as a note under section 1 of this title.

#### EFFECTIVE DATE OF 1988 AMENDMENT

Pub. L. 100-647, title I, §1012(v)(2)(B), Nov. 10, 1988, 102 Stat. 3529, provided that: “The amendment made by subparagraph (A) [amending this section] shall not apply in any case in which the taxpayer takes or makes delivery before June 11, 1987.”

Amendment by section 1012(v)(3), (4), (6)–(8) of 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.

Pub. L. 100-647, title VI, §6130(d), Nov. 10, 1988, 102 Stat. 3719, provided that:

“(1) IN GENERAL.—The amendments made by this section [amending this section and section 1092 of this title] shall apply with respect to forward contracts, future contracts, options, and similar instruments entered into or acquired after October 21, 1988.

“(2) TIME FOR MAKING ELECTION.—The time for making any election under subparagraph (D) or (E) of section 988(c)(1) of the 1986 Code shall not expire before the date 30 days after the date of the enactment of this Act [Nov. 10, 1988].

“(3) TRANSITIONAL RULES.—

“(A) The requirements of subclause (IV) of section 988(c)(1)(E)(iii) of the 1986 Code (as added by subsection (b)) shall not apply to periods before the date of the enactment of this Act.

“(B) In the case of any partner in an existing partnership, the 20-percent ownership requirements of subclause (I) of such section 988(c)(1)(E)(iii) shall be treated as met during any period during which such partner does not own a percentage interest in the capital or profits of such partnership greater than

33½ percent (or, if lower, the lowest such percentage interest of such partner during any prior period after October 21, 1988, during which such partnership is in existence). For purposes of the preceding sentence, the term ‘existing partnership’ means any partnership if—

“(i) such partnership was in existence on October 21, 1988, and principally engaged on such date in buying and selling options, futures, or forwards with respect to commodities, or

“(ii) a registration statement was filed with respect to such partnership with the Securities and Exchange Commission on or before such date and such registration statement indicated that the principal activity of such partnership will consist of buying and selling instruments referred to in clause (i).”

#### 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.

### § 989. Other definitions and special rules

#### (a) Qualified business unit

For purposes of this subpart, the term “qualified business unit” means any separate and clearly identified unit of a trade or business of a taxpayer which maintains separate books and records.

#### (b) Appropriate exchange rate

Except as provided in regulations, for purposes of this subpart, the term “appropriate exchange rate” means—

(1) in the case of an actual distribution of earnings and profits, the spot rate on the date such distribution is included in income,

(2) in the case of an actual or deemed sale or exchange of stock in a foreign corporation treated as a dividend under section 1248, the spot rate on the date the deemed dividend is included in income,

(3) in the case of any amounts included in income under section 951(a)(1)(A) or 1293(a), the average exchange rate for the taxable year of the foreign corporation, or

(4) in the case of any other qualified business unit of a taxpayer, the average exchange rate for the taxable year of such qualified business unit.

For purposes of the preceding sentence, any amount included in income under section 951(a)(1)(B) shall be treated as an actual distribution made on the last day of the taxable year for which such amount was so included.

#### (c) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subpart, including regulations—

(1) setting forth procedures to be followed by taxpayers with qualified business units using a net worth method of accounting before the enactment of this subpart,

(2) limiting the recognition of foreign currency loss on certain remittances from qualified business units,

(3) providing for the recharacterization of interest and principal payments with respect to obligations denominated in certain hyperinflationary currencies,