No. 2024-315
August 19, 2024

Proposed regulations: Guidance regarding elections relating to foreign currency gains and losses

The U.S. Treasury Department and IRS today released proposed regulations (REG-111629-23) regarding the time for making and revoking certain elections relating to foreign currency gain or loss.

Background

Section 988 generally requires a taxpayer, including a controlled foreign corporation (CFC), to compute foreign currency gain or loss from holding nonfunctional currency or entering into certain transactions when the underlying payments are denominated in, or determined by reference to the value of, nonfunctional currency. Regulations proposed in 2017 (the 2017 Proposed Regulations) would allow a taxpayer to elect to use a mark-to-market method of accounting for computing its foreign currency gain or loss under section 988 (the Proposed Mark-to-Market Election). Under the 2017 Proposed Regulations, a taxpayer would make the election on its timely-filed, original return for the year to which the election would relate. Additionally, a taxpayer would be permitted to revoke its first election under these rules without consent at any time. Taxpayers were permitted to rely on these provisions of the 2017 Proposed Regulations for tax years ending on or after December 19, 2017, until finalized, allowing taxpayers to selectively recognize foreign currency losses by determining their foreign currency gain or loss for the relevant tax year before choosing to make such election.

Under section 954, the excess of foreign currency gains over losses attributable to section 988 transactions is included in a CFC’s subpart F income as a separate category of foreign personal holding company income (FPHCI) unless related to the business needs of such CFC. Existing regulations under section 954 allow a controlling U.S. shareholder to elect to (1) treat foreign currency gains or losses otherwise includible as a separate category of FPHCI of its CFC as instead includible in the category of subpart F income to which it relates or (2) treat the CFC’s net foreign currency gain or loss attributable to any section 988 transaction (subject to limited exception) or any section 1256 contract that would otherwise be a section 988 transaction as FPHCI, (such elections, the Section 954 Currency Elections). Under the existing regulations, once a taxpayer has made one of these elections, such election may not be revoked without consent of the Commissioner. However, the 2017 Proposed Regulations would allow a taxpayer to revoke its first election under these rules without consent at any time, but would not allow the taxpayer to make a subsequent election until the sixth year after it is revoked (or to revoke the subsequent election for six years after it is made). Taxpayers were also permitted to rely on these provisions of the 2017 Proposed Regulations for tax years ending on or after December 19, 2017, until finalized.

Proposed regulations

Today's proposed regulations (the 2024 Proposed Regulations) withdraw and repropose provisions from the 2017 Proposed Regulations relating to the revocation of the Proposed Mark-to-Market Election and the Section 954 Currency Elections and modify the existing regulations relating to the time for making an original Section 954 Currency Election. The 2024 proposed regulations are proposed to be effective for tax years of taxpayers and CFCs, as applicable, ending on or after the date published as final in the Federal Register. Taxpayers may rely on these proposed regulations until finalized. However, the changes made to the 2017 Proposed Regulations by the 2024 Proposed Regulations take effect as of the date these proposed regulations are published in the Federal Register (anticipated to be August 20, 2024), eliminating the benefit of hindsight allowed under the 2017 Proposed Regulations (as well as the freedom to revoke original elections at any time).

More specifically, the 2024 proposed regulations:

- Modify the existing regulations under section 954 to provide that a Section 954 Currency Election must be made by the controlling U.S. shareholder on its original, timely-filed tax return for the tax year of the CFC ending with or within the shareholder's tax year;
- Modify the 2017 Proposed Regulations to provide that an original Section 954 Currency Election cannot be revoked until the sixth tax year following the year in which made (and then cannot be re-elected before the sixth tax year following the year in which revoked);
- Modify the 2017 Proposed Regulations to provide a taxpayer may no longer make the Proposed Mark-to-Market Election on its tax return for the tax year in which it is to be effective, but instead must make such election on its original, timely-filed tax return for the tax year immediately preceding the year in which it is to be effective; and
- Modify the 2017 Proposed Regulations to provide that a taxpayer may no longer revoke its Proposed Mark-to-Market Election at any time, but instead applies to all subsequent years unless revoked by or with the consent of the Commissioner.

Comments and requests for a public hearing must be received by October 18, 2024.

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