KPMG

Notice 2026-17 guidance on taxable income or loss and foreign currency gain or loss with respect to a QBU

KPMG analysis and observations on Notice 2026-17

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Introduction

On December 10, 2024, the U.S. Department of the Treasury and IRS (collectively, "**Treasury**") released final regulations (the "**2024 Final Regulations**")[1] and proposed additional regulations (the "**2024 Proposed Regulations**")[2] under section 987. The 2024 Final Regulations, applicable to tax years beginning after December 31, 2024, implemented the foreign exchange exposure pool (**FEEP**) method that calculates unrecognized section 987 gain or loss annually based on the change in the net value of a section 987 qualified business unit (**QBU**).[3] For a detailed analysis of the 2024 Final Regulations and 2024 Proposed Regulations, including certain provisions discussed herein, please see the December 2024 KPMG report.

Notice 2026-17 (the "**Notice**"), released on February 25, 2026, announced Treasury's intention to modify certain provisions of the 2024 Final Regulations and provide additional elections to simplify the application of section 987 (the "**forthcoming proposed regulations**"). Specifically, Treasury expects the forthcoming proposed regulations will include –

- An election to use an equity and basis pool method based on the regulations proposed on September 25, 1991 (56 FR 48457) (the "**1991 Method**"),[4]
- An election to not recognize section 987 gain or loss with respect to QBUs owned by a controlled foreign corporation[5] (a "**CFC**" and the "**CFC election**"),[6]
- Modifications to when section 987 losses will be suspended and recognized,[7]
- Modifications to the recognition groupings for purposes of recognizing suspended section 987 losses,[8]
- Modifications to when section 987 gain or loss on the termination of a QBU will be deferred,[9] and
- Modifications to the definition of a section 987 hedging transaction.[10]

Proposed applicability dates and reliance

- The proposed changes, when finalized, are expected to apply to tax years ending on or after the date the final regulations adopting these rules are published in the Federal Register.

- For any tax year to which the 2024 Final Regulations apply that ends before the proposed regulations are published in the Federal Register, taxpayers may rely on all provisions of the Notice **other than the CFC election**, provided that the taxpayer and all members of its section 987 electing group apply the rules in their entirety and consistently.[11]

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[1] T.D. 10016, 89 F.R. 100138 (Dec. 11, 2024).
[2] REG-117213-24, 89 F.R. 99782 (Dec 11, 2024).
[3] A section 987 QBU is an eligible qualified business unit of a taxpayer that does not use the U.S. dollar or the owner's currency as its functional currency. Reg. 1.987-1(b)(3).
[4] Section 3 of the Notice.
[5] As defined in section 957(a).
[6] Section 5 of the Notice.
[7] Section 4.02 of the Notice.
[8] Section 4.03 of the Notice.
[9] Section 4.04 of the Notice.
[10] Section 4.05 of the Notice.
[11] Section 6 of the Notice.

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- Taxpayers cannot rely on the current Notice to make the CFC election.[12] However, Treasury expects to provide future guidance to implement such election.

The equity and basis pool method election

Under the 1991 method, taxpayers maintained an equity pool in the section 987 QBU's functional currency and a basis pool in the owner's functional currency. The equity pool was adjusted for transfers, income, and loss with corresponding adjustments to the basis pool at specified translation rates. The owner recognized section 987 gain or loss upon a remittance, which was determined by netting all disregarded transfers daily, from the equity pool based on the spot rate on the date of the remittance and a pro rata portion of the basis pool.

Election timing and requirements

The forthcoming proposed regulations will include an election to use the 1991 method with modifications (the "**equity and basis pool method**"), providing a different approach to calculating section 987 gain or loss. The election will replace the alternative method for calculating QBU net value[13] and would be available in a tax year in which a current rate election (**CRE**) is in effect.

KPMG observation

The 2024 Final Regulations contain an alternative calculation for computing the end of year QBU net value that was intended to allow taxpayers to apply an approach similar to the 1991 method. The addition of the equity and basis pool method election will eliminate the need for the alternative calculation of QBU net value.

The equity and basis pool method election would be subject to the same general requirements as other section 987 elections provided in the 2024 Final Regulations, including the consistency requirement that applies to all members of a section 987 electing group. The Notice provides that the election could be made by the authorized person on a timely filed original return for the tax year for which the election is made, without obtaining the consent of the Commissioner.

KPMG observation

The ability to make the equity and basis pool method election on a timely filed original return in any tax year would be a departure from the limitation on timing that applies to existing section 987 elections which, absent consent from the Commissioner, must be made in the first year to which the 2024 Final Regulations apply or, for a current rate, annual recognition, and section 988 mark-to-market election made in a year after the first applicable year, must be made before the start of the year to which the election will apply.

Since the equity and basis pool method election would only be available when a CRE is in effect, taxpayers should be aware of this difference in election timing requirements and will need to determine whether to make the election prior to the start of the year to ensure a CRE is in effect.

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[12] *Id*.
[13] Reg. 1.987-4(e)(2)(iii)

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The Notice does not explicitly discuss whether the election would be revocable; however, by eliminating the need for consent only when making the election, the consent requirement is implicitly retained for revocations.

Because the 2024 Final Regulations do not in general apply to partnerships or section 987 QBUs owned by or through partnerships or S corporations, the election would not be available for partnerships or S corporations. However, the 2024 Final Regulations require that section 987 be applied to partnerships and QBUs owned by or through partnerships and S corporations in a reasonable manner, and the Notice confirms that a method consistent with the equity and basis pool method is a reasonable application of section 987.

The methodology

- A taxpayer that elects the equity and basis pool method will maintain an equity pool and a basis pool. The ending balances in these pools will determine the unrecognized section 987 gain or loss, which will be recognized at the time of a remittance based on the remittance proportion.

- The equity and basis pool method will determine how taxpayers translate taxable income of a section 987 QBU, compute the unrecognized section 987 gain or loss, and compute the remittance proportion.

- All other provisions of the 2024 Final Regulations will generally still apply. Therefore, taxpayers making the equity and basis pool method election will still need to calculate their pretransition gain or loss and determine what additional elections they will make.

- Because most of the provisions in the 2024 Final Regulations will still apply, the following will be computed in the same manner for any taxpayer for which a CRE is made regardless of whether the equity and basis pool method election is made –

    - Taxable income: the taxable income of the section 987 QBU would be computed in the functional currency of the QBU, translated using the average rate for the year, and adjusted to account for foreign taxes claimed as a credit

    - Amount of transfers: Disregarded transfers of the section 987 QBU would be translated, as necessary, using the spot rate on the date of transfer (except in the case of certain recurring transfers if the proposed recurring transfer group election is made[14])

    - Remittance: whether there has been a remittance would be determined by netting all transfers in the year

    - Loss suspension: section 987 loss that would otherwise be recognized could be suspended under the general rules that apply when a CRE is in effect

- However, making the equity and basis pool method election would result in a different methodology for determining unrecognized section 987 gain or loss from the general methodology contained in the Final 2024 Regulations –

[14] *See* Prop. Reg. 1.987-2(f) of the 2024 Proposed Regulations.

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- In lieu of determining the net value of the QBU on an annual basis using a balance sheet approach, the owner would maintain an equity pool in the section 987 QBU's functional currency and a basis pool in the owner's functional currency. The pools would be adjusted to reflect current year activity.

Item	Equity pool	Basis pool
Opening balance – new section 987 QBUs when election is already in effect	Zero	Zero
Opening balance – existing section 987 QBUs for tax years beginning on transition date and election made for tax year beginning on transition date	The net value of the QBU determined under US tax principles on the day before the transition date	• Opening balance of the equity pool translated using the spot rate on the day before the transition date or building up the equity pool from the beginning of QBU life. • Increased by the pretransition loss or decreased by pretransition gain that is unrecognized. • No adjustment is made for pretransition gain or loss if the amortization election is made.
Opening balance – existing section 987 QBUs at time of election (other than year beginning on transition date)	The net value of the QBU determined under US tax principles on the last day of preceding tax year	• Opening balance of the equity pool translated using the spot rate on last day of preceding tax year • Increased by the unrecognized section 987 loss or decreased by the unrecognized section 987 gain accumulated prior to election being in effect
Transfers from the owner	• Transfers translated using the spot rate on the date of the transfer • Translated using the average rate if recurring transfer group is in effect	**Increase** for the basis of assets transferred to the section 987 QBU or the amount of liabilities assumed by the owner
Transfers from the section 987 QBU	**Decrease** for the basis of assets transferred to the owner or the amount of liabilities assumed by the section 987 QBU	• Transfers translated using the spot rate on the date of the transfer • Translated using the average rate if recurring

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Item	Equity pool	Basis pool
		transfer group election is in effect
Income or loss	• **Increase** for income and gain • **Decrease** for deduction and loss • Include tax-exempt income and non-deductible expenses • Exclude items that do not impact the adjusted balance sheet	• The amounts included in the equity pool are translated at yearly average exchange rate

- If the election to use the equity and basis pool method was in effect in the prior year, the basis pool would increase for section 987 gain recognized and decrease for section 987 loss recognized or suspended in the prior year.

KPMG observation

Taxpayers that had previously applied the 1991 method would not necessarily be able to use their ending equity and basis pools prior to the transition to the Final 2024 Regulations as the opening balance of the post-transition equity and basis pools may not match. For instance, there could be differences if the historic equity pool was not maintained consistent with the equity and basis pool method or does not equal the tax basis net value of the QBU on the transition date.

- The **net unrecognized section 987 gain or loss** with respect to the section 987 QBU would equal the ending equity pool translated into the owner's functional currency at the spot rate on the last day of the tax year, minus the ending basis pool.
    - If the owner has entered into a section 987 hedging transaction (as defined in the 2024 Final Regulations) with respect to the section 987 QBU, the gain or loss on the section 987 hedging transaction will increase or decrease the net unrecognized section 987 gain or loss. The amount of unrecognized section 987 gain or loss that can be adjusted by the section 987 hedging transaction in the current year would be the net unrecognized section 987 gain or loss calculated in the current year minus the amount computed in the prior year.
- To determine the remittance proportion, the denominator would equal the sum of the equity pool, liabilities (expressed as a positive number), and the remittance amount.

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Proposed regulations to be issued related to the application of section 987(3) to CFCs

- The Notice provides that Treasury intends to issue future guidance that would include the CFC election, under which CFCs would generally not be required to compute or recognize section 987 gain or loss. However, section 987 would still apply for purposes of computing the section 987 QBU's taxable income and the CFC's E&P.

- Treasury intends that the election would be made by the authorized person on a timely filed original return and could be revoked only with the consent of the Commissioner. A taxpayer would be required to make the CFC election consistently for all CFCs controlled by the taxpayer and its related parties and special consistency rules would address situations where a CFC is acquired from an unrelated person.

- Transition rules would account for unrecognized Section 987 gain or loss accumulated before the CFC election is made, which would be recognized pro rata over 120 months starting with the first month of the tax year the election is made.

- However, in the event a CFC subject to the CFC election undergoes an inbound asset reorganization or liquidation, special rules would be provided to account for the amount by which the CFC's asset basis had increased due to unrecognized currency gain (its "section 987 basis increase") while the CFC election was in effect. The section 987 basis increase would be subject to a de minimis threshold and recognized in the transaction year or in a future year.

    - Treasury is considering allowing taxpayers to determine a CFC's section 987 basis increase by computing net unrecognized section 987 gain for the 10 years prior to the transaction using a simplified balance sheet methodology or relying on the "excess asset basis" calculation provided in the section 367(b) regulations. Additionally, Treasury is considering whether the cumulative translation account under U.S. GAAP could be utilized.

    - Treasury is considering whether the section 987 basis increase should be recognized by the CFC immediately before the transaction, reduce the domestic acquiring corporation's basis in the acquired assets, or, if the transaction results in the domestic acquiring corporation becoming the owner of a section 987 QBU, become unrecognized section 987 gain of such section 987 QBU.

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Other proposed changes to the 2024 Final Regulations

Loss suspension rules

The loss suspension rule that applies when a CRE is in effect and that applies to partnerships, would only apply in a tax year with respect to a section 987 QBU if either:

- The **remittance proportion** for the section 987 QBU or successor deferral QBU exceeds **five percent**, or
- The total amount of net unrecognized section 987 loss or deferred section 987 loss that would otherwise be suspended **exceeds $5 million**.

KPMG observation

The proposed changes measure the de minimis threshold on a QBU by QBU basis rather than at the controlled group, which allows more section 987 loss to be recognized in a given tax year.

Recognition grouping requirement

For purposes of determining the amount of suspended loss recognized in a year under the "loss-to-the-extent-of-gain" rule, section 987 gain or loss of a U.S. owner would be treated as being in a **single recognition grouping**. The section 987 gain or loss of a CFC owner would be divided into four recognition groupings: tentative tested income, subpart F income groups, income effectively connected with a U.S. trade or business (ECI) described in section 952(b), and other income.

KPMG observation

The modification would only apply for purposes of the “loss-to-the-extent-of-gain" rule and would not change the group to which a loss is assigned for purposes of a CFC’s subpart F calculation. Therefore, while this relaxation could result in a section 987 loss in one subpart F group being unsuspended on account of section 987 gain in another subpart F group, the taxpayer may not realize a benefit from its section 987 loss if it does not have sufficient income in the subpart F group to which the loss is assigned.

Definition of successor deferral QBU

Section 987 gain or loss on certain section 987 QBU terminations would be deferred only if **a significant portion** of the terminated QBU's assets are reflected on the books and records of a section 987 QBU within the controlled group (“successor deferral QBU”).

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KPMG observation

Under the 2024 Final Regulations, an owner would have deferred section 987 gain or loss if any assets of the terminated QBU were reflected on the books and records of a section 987 QBU within the controlled group. The modification may result in fewer terminations being subject to the deferral rules, thereby increasing section 987 gain or loss recognized on terminations.

Definition of section 987 hedging transaction

The forthcoming proposed regulations would eliminate the requirement that foreign currency gain or loss on a section 987 hedging transaction must be accounted for as a cumulative foreign currency translation adjustment to shareholders' equity under U.S. GAAP. A hedge entered into before April 26, 2026 that does not meet this requirement would be treated as timely identified as a section 987 hedging transaction if it is identified before such date and the owner identifies substantially all of the hedges with respect to the hedged section 987 QBU (including hedges meeting the requirement) as section 987 hedging transactions.

Request for comments

Treasury requests comments on the rules described above and specifically requests comments on the following issues:

- Whether the cumulative translation adjustment is an appropriate proxy for foreign currency gain that would otherwise be recognized under section 987(3) for purposes of determining the amount of the section 987 basis increase. Treasury also asked what adjustments would be needed to avoid material distortions, such as preventing duplication or omission of foreign currency gain or loss when a section 987 QBU owns other foreign entities.

- How the section 987 basis increase rules should interact with other provisions that may apply to inbound reorganizations and liquidations, specifically sections 362(e)(1) and 367(b).

- What de minimis threshold should apply for purposes of the section 987 basis increase rules.

- Whether stock of a lower-tier CFC owned by the transferor CFC should be taken into account as an asset of the transferor CFC for purposes of the de minimis rule. This is particularly relevant in cases where the basis of the lower-tier CFC stock might be affected by the section 987 basis increase due to a contribution of the assets of a section 987 QBU.

- Whether and how the hedging rules of § 1.987-14 should apply if the CFC election is in effect.

- How the rules described in section 5 of the notice should apply, if at all, in the case of a partnership in which one or more of the partners is a CFC.

Written comments are requested on these issues by April 26, 2026.

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