



Proposed regulations on foreign currency gain or loss with respect to a QBU of controlled foreign corporations

**KPMG analysis and observations on proposed
regulations under sections 987(3)**

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Introduction

The U.S. Department of the Treasury and IRS on August 13, 2026, released proposed regulations under section 987 (the “**2026 Proposed Regulations**”)¹ addressing foreign currency gain or loss with respect to qualified business units (“**QBUs**”) of controlled foreign corporations (“**CFCs**”). For a detailed analysis of previously published guidance under section 987, read [TaxNewsFlash](#) regarding final regulations and proposed regulations published in 2024 (the “**2024 Final Regulations**” and “**2024 Proposed Regulations**”),² [TaxNewsFlash](#) on Notice 2025-72, and [TaxNewsFlash](#) on Notice 2026-17.

The 2026 Proposed Regulations would provide an election under which a CFC generally would not compute or recognize section 987 gain or loss on remittances under section 987(3), except in connection with certain inbound nonrecognition transactions (the “**CFC exemption election**”), as previewed in Notice 2026-17. Section 987(1), section 987(2), and the related regulations would continue to apply to the CFC for purposes of determining and translating section 987 taxable income or loss. The 2026 Proposed Regulations would also modify the pretransition amortization election from 10 years to 120 months, consistent with Notice 2025-72.

Applicability dates and reliance

- The provisions in the 2026 Proposed Regulations relating to the CFC exemption election would generally apply to tax years ending on or after the date final regulations are filed with the Federal Register. However, taxpayers may rely on the 2026 Proposed Regulations for tax years beginning after December 31, 2024, and ending before the finalization date, subject to the modified consistency requirements (discussed in detail below).
- The provision modifying the pretransition amortization election from 10 years to 120 months would be applicable for tax years beginning after December 31, 2024, and ending on or after November 25, 2025. Taxpayers may separately rely on that particular provision without relying on the other 2026 Proposed Regulations provided it is applied consistently within its consolidated and section 987 electing group.

CFC exemption election

- For tax years beginning after December 31, 2024, a CFC may make the CFC exemption election to not apply section 987(3) and the related regulations (“**exempt CFC**”). The relief would allow an exempt CFC to not compute or recognize section 987 gain or loss on remittances or section 987 QBU terminations, except upon certain inbound nonrecognition transactions (discussed in more detail below).
- However, other section 987 provisions would continue to apply to section 987 QBUs of exempt CFCs, including the rules for attributing items to eligible QBUs, determining section 987 taxable income or loss, determining basis of transferred assets and liabilities, applying partnership rules, applying transition rules and maintaining records necessary to substantiate any relevant determinations under the CFC exemption election.

¹ REG-103844-26, 91 F.R. 52553 (Aug. 14, 2026).

² T.D. 10016, 89 F.R. 100138 (Dec. 11, 2024).



- When a CFC exemption election is in effect, a section 987 QBU's taxable income would be determined as if a current rate election were in effect. In addition, because the regulations apply for purposes of computing taxable income or loss and a CFC's earnings and profits, an exempt CFC could make certain other elections (e.g., spot rate convention election and 988 mark-to-market election).

Pre-election section 987 gain or loss

Mandatory recognition over a 120-month period

- To prevent the CFC exemption election from eliminating historic section 987 gain or loss that arose prior to the election, pre-election section 987 gain or loss would be computed and recognized over a 120-month period.
 - If the CFC exemption election is made effective for the first tax year to which the 2024 Final Regulations apply, historic section 987 gain or loss generated prior to the election would be accounted for under the general pretransition rules and no further pre-election calculations would be required, except in the case of exempt partnership QBUs (see further discussion below).
 - The exempt CFC would be deemed to make the amortization election for its pretransition gain or loss with respect to its section 987 QBUs such that the amount would be recognized ratably over 120 months.
 - The deemed amortization election would apply only to CFCs covered by the CFC exemption election and does not require non-exempt owners (i.e., US corporations) in the same section 987 electing group to amortize their pretransition gain or loss.
 - If the CFC exemption election is made for a year after the first tax year to which the 2024 Final Regulations apply, pre-election section 987 gain or loss would generally be the sum of the CFC's net unrecognized section 987 gain or loss, outstanding deferred section 987 gain or loss, and cumulative suspended section 987 loss with respect to the relevant QBU as of the last day of the preceding tax year, reduced by amounts recognized, suspended, deferred, eliminated, or attributed to another QBU.
 - If a current rate election is not in effect for the tax year immediately preceding the first year to which the CFC exemption election applies, pre-election section 987 gain or loss with respect to a section 987 QBU would be adjusted to account for the change in owner functional currency net value attributable to the deemed current rate election that applies once the CFC exemption election is in effect.

De minimis rule

- The 2026 Proposed Regulations would treat an exempt CFC as having no pre-election section 987 gain or loss with respect to a QBU that has average assets of less than \$50 million for the three tax years preceding the first tax year for which the CFC exemption election applies. The amount of a QBU's assets for this purpose is based on total assets reflected on the QBU's U.S. GAAP balance sheet on the last day of the relevant tax year, without adjustment to conform to federal income tax principles.



- For this purpose, an exempt CFC must aggregate all section 987 QBUs by country of residence and treat them as a single QBU.
- If the CFC exemption election is made for the tax year beginning on the transition date, an exempt CFC also would be treated as having no pretransition gain or loss with respect to a QBU that satisfies the de minimis threshold.

KPMG observation

The \$50 million threshold is broader than the small business transition relief in the 2024 Final Regulations because it does not depend on the owner satisfying a gross receipts test. However, the reliance on the U.S. GAAP balance sheet could increase assets for this purpose by including assets that would otherwise not be attributed to a section 987 QBU, such as non-portfolio stock.

Source and character of pre-election amounts

- The source and character of the pre-election section 987 gain or loss would generally be determined under the asset method by reference to the tax year immediately preceding the first year in which the CFC exemption election applies.
- Deferred section 987 gain or loss and suspended section 987 loss would retain the source and character determined in the tax year of deferral or suspension.

Partnerships owned by exempt CFCs

- The 2024 Final Regulations generally do not apply to partnerships and instead, require taxpayers to apply section 987 to partnerships (and to section 987 QBUs owned by partnerships) using a reasonable method that is applied consistently. The 2026 Proposed Regulations, however, would provide specific rules for applying the CFC exemption election to certain CFC-owned partnership structures.
 - The CFC exemption election would apply where an exempt CFC partner treats a partnership, or an interest in a partnership, as a section 987 QBU of the CFC partner under a reasonable method and where an exempt CFC owns a section 987 QBU indirectly through an “exempt partnership” (an “exempt partnership QBU”).
 - A partnership is an “exempt partnership” if at least 80% of its capital or profits interests is owned (directly or indirectly through other partnerships) by exempt CFCs that are members of the same controlled group.
 - If a partnership meets the definition when the election is made, the CFC exemption election would apply from that year. The CFC exemption election is treated as being made or revoked in the year a partnership becomes or ceases to be an exempt partnership.
 - An exempt partnership QBU would compute a pre-election section 987 gain or loss as if it terminated in the year immediately preceding the election year. Each owner of an exempt partnership QBU or partner in an exempt partnership would take into account the pre-election section 987 gain or loss over 120 months. A partner’s share is fixed and allocated as if the entire amount is recognized in the election year using distributive-share concepts.



- A partner would adjust its outside basis in the partnership as the exempt CFC recognizes pre-election gain/loss on an exempt partnership QBU.

KPMG observation

The application of the CFC exemption election to section 987 QBUs held by or through a partnership structure in conjunction with the expanded consistency rules that apply to the election may present a challenge to taxpayers making the CFC election in the transition year because historic section 987 gains or losses of partnership must be calculated and recognized and may impact the taxable income in the transition year, even though pretransition gain or loss would not have been calculated or recognized with respect to the partnership's QBUs under the final regulations had the CFC exemption election not been made.

Expanded consistency requirement

- The 2024 Final Regulations currently require consistency with respect to section 987 elections among section 987 QBUs owned by a consolidated group, including CFCs and foreign partnerships controlled by its members. The 2026 Proposed Regulations would expand the scope of the consistency rules for purposes of the CFC exemption election to include affiliated domestic corporations that are not part of the consolidated group and CFCs held through domestic partnerships.
- Anti-avoidance rules would address related-party transactions entered into with a principal purpose of avoiding the consistency requirements or causing an inappropriate deemed revocation.

KPMG observation

The proposed modification to the consistency requirement is notable in that taxpayers may need to consider the implications of the CFC exemption election on CFCs that would otherwise have been permitted to have different elections for section 987 purposes.

Election timing and revocation

- The CFC exemption election would generally be subject to the existing rules for making and revoking section 987 elections such that the election would need to be made prior to the start of the year to which the election would apply and generally could not be revoked without the consent of the Commissioner.
- However, special timing rules would apply for tax years beginning after December 31, 2024, and ending on or before December 31, 2027.
 - For tax years beginning in 2025, the election may be made by attaching an election statement to the authorized person's original timely filed return, including extensions, or on an amended return filed before October 15, 2027.
 - For tax years ending in 2026, the election may be made by attaching an election statement to the authorized person's original timely filed return, including extensions.



- For tax years ending in 2027, the authorized person may make the election by filing the election statement on or before October 15, 2027, and attaching a copy to the return for that tax year.
- The authorized person is the controlling domestic shareholder of the CFC or the partnership, if the partnership is the owner of the section 987 QBU.

KPMG observation

The October 15, 2027, date provides meaningful transition relief for calendar-year taxpayers deciding whether to make the election for 2025, 2026, or 2027. Specifically, taxpayers have the benefit of hindsight for purposes of making the election in 2025 and 2026.

Inbound nonrecognition transactions

- Although the CFC exemption election generally would eliminate section 987(3) gain or loss recognition for ordinary CFC branch operations, section 987 gain would be recognized by a transferor CFC in certain inbound nonrecognition transactions if the CFC exemption election was in effect for any tax year ending during the 72-month period ending on the date of the transaction. The 2026 Proposed Regulations would not provide a corresponding rule for recognizing section 987 loss.
 - Section 987 gain would not be recognized as part of the inbound nonrecognition transaction but immediately before. Accordingly, the domestic acquiring corporation's basis in the acquired assets would not be increased by the section 987 gain recognized.
- The amount of section 987 gain would be equal to the section 987 asset basis that a transferor CFC would compute in connection with an inbound nonrecognition transaction. Under the 2026 Proposed Regulations, taxpayers would have the option of using one of two methods.
 - **Lookback methodology:** The CFC's section 987 asset basis would generally equal the aggregate net amount of annual unrecognized section 987 gain or loss for each tax year ending during the 72-month pre-transaction period for which the CFC exemption election was in effect determined under the simplified method used by owners that were not on an eligible pretransition method (i.e., steps 1 and 10 of FEET).
 - Annual unrecognized section 987 gain or loss would be computed with respect to each section 987 QBU, including each exempt partnership QBU, owned by the transferor CFC during the relevant pre-transaction tax years.
 - Annual unrecognized section 987 gain or loss for an exempt partnership QBU would equal the amount of gain or loss that the owner would have recognized under section 987(3) if the QBU were formed on the later of the first day of the tax year or the actual formation date and terminated on the earlier of the last day of the tax year or the actual termination date. The amount would be determined using a reasonable method applied consistently with respect to all partnerships in which the transferor CFC is a partner.
 - **Excess asset basis methodology:** A CFC's section 987 asset basis would equal the transferor CFC's excess asset basis determined under Treas. Reg. § 1.367(b)-3(g)(2)(i) and would rely on asset basis, earnings and profits, outside stock basis, and liabilities determined at the time of the inbound nonrecognition transaction, rather than historical section 987 computations.



- The section 987 asset basis rules would apply before excess assets basis is determined under Treas. Reg. § 1.367(b)-3(g).
- **De minimis rule:** The 2026 Proposed Regulations would provide a de minimis rule under which the section 987 asset basis computation and gain recognition rules would not apply if the transferor CFC's inside asset basis (as determined for U.S. federal income tax purposes) is less than \$25 million. If multiple inbound nonrecognition transactions occur as part of the same plan or arrangement, the assets of all transferor CFCs would be aggregated for this purpose.
 - Inside asset basis (determined under Treas. Reg. § 1.367(b)-3(g)(2)(iv)) would generally equal the adjusted basis of all assets in the hands of the acquiring corporation immediately after the transaction. For this purpose, all assets of the CFC would be taken into account whether or not they are attributable to a section 987 QBU but would exclude non-portfolio stock of a corporation, except to the extent other assets or functional currency of the transferor CFC were exchanged for the stock during the 72-month pre-transaction period.

120-month amortization rule for pretransition gain or loss

- Consistent with Notice 2025-72, the 2026 Proposed Regulations would modify the amortization election for pretransition gain or loss by replacing the ten-taxable-year recognition period with a 120-month recognition period.
- If an owner recognized a portion of pretransition gain or loss under the prior ten-year amortization rule before the proposed 120-month rule applies, the 2026 Proposed Regulations would treat each such tax year as having twelve months. Thus, if an owner recognized one-tenth of pretransition gain or loss in a one-month short tax year under the prior rule, the owner would recognize the remaining amount over 108 months beginning with the first month of the next tax year.

Requests for comments

In the preamble to the 2026 Proposed Regulations, Treasury generally requests comments on all the rules described above and specifically requests comments on the following issues:

- Whether additional methodologies should be permitted for computing section 987 asset basis in inbound nonrecognition transactions.
- How the proposed consistency rules should apply in acquisition transactions, including cases in which an acquired CFC's tax year does not end at the time of the acquisition.
- How to coordinate the consistency rules with statutory changes enacted by Pub. L. No. 119-21 (the "One Big Beautiful Bill Act" (OBBBA)), including the modified pro rata share rules.
- Whether alternative partnership basis adjustment rules are appropriate for pre-election section 987 gain or loss, including whether an exempt CFC should adjust the basis of its partnership interest by the full amount of its pre-election section 987 gain or loss in the first tax year in which the election applies.



- Whether recognition should be accelerated when an exempt CFC sells a partnership interest during the 120-month amortization period.
- Whether special rules should apply to transfers of partnership interests in transactions described in sections 351 or 721.

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