



United States Tax Alert Notice 2017-57 defers applicability date of section 987 regulations

On October 2, 2017, Treasury and the IRS issued Notice 2017-57 (the "Notice"), announcing their intent to defer the applicability date of the final section 987 regulations (and certain temporary section 987 regulations) by one year.

In the Notice, the government pronounced that it intends to amend the final section 987 regulations to defer the applicability dates. In the meantime, taxpayers can rely on the Notice regarding such proposed amendments. Specifically, the final section 987 regulations (and related temporary regulations) will apply to "taxable years beginning on or after two years after the first date of the first taxable year following December 7, 2016." For example, for calendar year taxpayers, the regulations will apply to the taxable year beginning on January 1, 2019.

Importantly, certain temporary regulations, including the section 987 deferral rules under Temp. Treas. Reg. §1.987-12T and the section 988 anti-abuse rule under Temp. Treas. Reg. §1.988-2T(b)(16), are not subject to the deferred applicability date and, therefore, are still currently applicable.

The Notice also provides that taxpayers may early-adopt the final section 987 regulations, provided that they apply the regulations consistently to all qualified business units (QBUs) owned directly or indirectly on the transition date. Thus, taxpayers can apply the final regulations to taxable years beginning after December 7, 2016 (starting with the first or second taxable year beginning after December 7, 2016).

Finally, the Notice provides that the government is considering changes to the final section 987 regulations to allow taxpayers to

elect alternative rules to (i) transition to the new regulations and (ii) determine section 987 gain or loss.

Second Report to the President issued by Treasury

In addition to the Notice, on October 4, 2017, Treasury issued the Second Report to the President on Identifying and Reducing Tax Regulatory Burdens (the "Second Report") providing further guidance with respect to section 987. The government first acknowledges that the final section 987 regulations "have proved difficult to apply for many taxpayers." As a result, the government intends to propose modifications to the final section 987 regulations to permit taxpayers to elect a simplified method of calculating section 987 gain or loss, subject to certain limitations on the timing of recognition of section 987 loss.

One of the methods under consideration would allow all assets and liabilities of a section 987 QBU to be treated as "marked" items, and all taxable income of a QBU to be translated at the yearly average rate. This method is similar to the approach set forth in the 1991 proposed regulations. The amount of section 987 gain or loss computed under such method would generally be consistent with any translation gain or loss determined under financial accounting rules. The government is considering alternative loss-recognition timing limitations that would apply to taxpayers who elect the above method. One alternative is to allow taxpayers the ability to recognize section 987 losses only to the extent of the net section 987 gains recognized in prior or subsequent years. The other alternative is to defer a taxpayer's section 987 gains and losses until the earlier of (i) the year the QBU's trade or business ceases to be conducted by any member of the taxpayer's controlled group or (ii) the year substantially all of the assets and activities of the QBU are transferred outside of the taxpayer's controlled group.

The government is also considering alternative methods for transitioning to the new regulations. One alternative would allow taxpayers that elect to apply the loss limitations (applicable to the simplified methodology described above) to elect to carry forward unrealized section 987 gains and losses, measured as of the transition date with certain adjustments. This alternative is similar to the "deferral" transition method in the 2006 proposed regulations and would be used in lieu of the "fresh start" method.

For those applying the "fresh start" transition method, the government is considering an election to use the spot exchange rate to translate all items on the opening balance of a QBU on the transition date. This would effectively result in the complete elimination of pre-existing section 987 gains and losses at the time of the fresh start. In comparison, under the default fresh start method, some of such gains or losses are preserved in the form of section 987 gain or loss on marked items or a basis difference in historic items.

Importantly, these transition alternatives and the simplified method alternatives would be elective. It appears that the government will retain the approach under the final section 987 regulations as the default method. By doing so, the government effectively compels taxpayers who find compliance with the final regulations to be unduly complex and financially burdensome to elect into some sort of a simplified method with loss limitations.

ASC 740 considerations

From an ASC 740 perspective, the Notice effectively establishes an administrative practice pursuant to which companies are not

required to adopt final regulations (and related temporary regulations) until “taxable years beginning on or after two years after the first date of the first taxable year following December 7, 2016.” Taxpayers should assess, in the financial reporting period that includes October 2, 2017, whether they intend to rely on the Notice to defer the applicability date of the regulations. Taxpayers intending to rely on the Notice should account for any impact the deferral of the applicability date will have in the financial reporting period that includes October 2, 2017. Specifically, such taxpayers should revise what impact the change in applicability date will have on their assessment of temporary differences and associated deferred taxes that will reverse before and after the revised applicability date, and record such impact in the financial reporting period that includes October 2, 2017. Taxpayers not intending to rely on the Notice as a means of deferring the effective date would not be impacted from an ASC 740 perspective and would continue to account for the final regulations (and related temporary regulations) in preparing their income tax provision.

Any subsequent actions by the government that modify the final regulations (and related temporary regulations) would be accounted for in the reporting period of such subsequent actions. All taxpayers should continue to monitor subsequent guidance that may be issued by the government as there could be further ASC 740 consequences when any future guidance is issued.

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