



5x5 series: Insights and actions

Impact of section 987 on investment management/ global funds and real estate structures



Investment management firms, global funds (real estate, infrastructure, etc.) and US real estate investment trusts (REITs) continue to invest in jurisdictions outside the United States, many with operations in varying foreign currency environments, which presents several tax considerations, including section 987. New proposed regulations under section 987 would, if finalized, bring funds and REITs under a new set of rules for section 987, impacting ongoing taxable income and basis computations, timing and character of gain and loss recognition, and much more. It is important to keep section 987 issues and developing regulatory guidance under section 987 in mind throughout the life of the fund or a REIT with investments in different currency environments.

5 insights you should know

Section 987 generally applies to individuals, corporations, and partnerships (“tax owners”) that own a pass-through qualified business unit (QBU) with a different functional currency than the tax owner: e.g., a USD partner with an interest in a EUR partnership, or a USD partnership that owns a EUR disregarded entity.

Until now, fund partnerships and REITs generally have had flexibility in adopting a method for compliance with section 987. The IRS’s 2023 proposed regulations, generally effective beginning in tax year 2025, will apply to many taxpayers (including fund partnerships and REITs) and will likely require a transition from the methods such taxpayers are currently applying.

Taxpayers can adopt the new regulations earlier than 2025. Even if a taxpayer does not adopt the regulations early, certain transactions that result in a termination of a QBU occurring after November 8, 2023 can result in a retroactive application of the new regulations and possible suspension of currency related losses.

Even if a transaction is otherwise disregarded for US tax purposes, the transaction may still result in a gain or loss being recognized under section 987.

The recent proposed regulations are not comprehensive, but future proposals may be more so. Taxpayers that still are not subject to specific proposals likely have, at least for a period of time, some flexibility in how they comply with section 987.

5 actions to take now

1

Understand your current QBUs. It will be critical for effective section 987 analysis and planning to understand where QBUs sit within your structure and what their currencies are, including partnership interests that are considered “per se” QBUs under section 989.

2

Understand your current methods under section 987. Understand which methods and regulations your organization is applying for section 987 purposes and whether and how the 2023 proposed regulations will apply to you. Taxpayers subject to the new regulations should assess their pre-transition section 987 gains and losses as soon as possible.

3

Consider section 987 when planning or analyzing transactions. Distributions from partnerships may trigger section 987 gain or loss. Transactions involving disregarded transfers of cash or other assets or liabilities may also trigger section 987 gain or loss.

4

Remember deemed terminations in transaction planning. A QBU can be deemed to terminate, depending on the facts of the transaction, including as a result of a large remittance, a sale of an interest, or a change in functional currency. Confirm whether a transaction results in a termination and if such termination results in the retroactive application of new regulations and potential section 987 gain recognition or section 987 loss suspension or deferral.

5

Consider and model loss deferral rules. Consider how the loss suspension and deferral rules included in the 2023 proposed regulations may impact taxable income estimates and projections for a taxpayer, including potential impact on LP/GP taxable income allocations (e.g., in respect of GP’s carried interest).

Connect with us

Aziza Yuldasheva
Tax Principal
Deloitte Tax LLP

Craig Foxgrover
Tax Managing Director
Deloitte Tax LLP

Michael Kohler
Tax Managing Director
Deloitte Tax LLP

Carter Lawnin
Tax Partner
Deloitte Tax LLP

Jason Nowak
Tax Partner
Deloitte Tax LLP

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