Tax Insights
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Services

Proposed regulations would ease Section 987 rules for CFCs

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In brief

What happened?

Treasury and the IRS on August 14, 2026, published proposed regulations that would allow taxpayers to generally elect out of computing and recognizing Section 987 gain or loss under Section 987(3) for qualified business units (QBUs) owned by controlled foreign corporations (CFCs), except in the case of inbound nonrecognition transactions. Under this proposed CFC exemption election, an electing CFC generally would no longer recognize Section 987 gain or loss on ordinary remittances or QBU terminations, although the rules for determining and translating QBU income or loss and transfers between a QBU and its owner would continue to apply. The framework also would extend to certain partnership-owned QBUs.

Why is it relevant?

The proposed regulations would reduce the recurring Section 987 compliance burden for many multinational groups, but the relief is not a complete exemption. The CFC exemption election generally must be applied consistently across commonly controlled CFCs, and pre-election Section 987 gain or loss generally would be amortized and recognized over 120 months, with an asset-based exception for qualifying QBUs with average assets over the preceding three-year period below $50 million. In addition, taxpayers should recognize Section 987 gain, but not loss, on certain inbound liquidations and reorganizations. Consistent with Notice 2025-72, the proposed regulations separately would revise the existing pretransition amortization election to use a 120-month convention, reducing distortions associated with short tax years.

Actions to consider

Taxpayers should evaluate the election as a group-wide planning decision rather than a QBU-by-QBU compliance choice. Key considerations include reducing the compliance burden while foregoing the ability to recognize future Section 987 losses, which year to make the election, given that the 120-month amortization of pre-election gain or loss will begin affecting taxable income in that year, whether the $50 million asset-based exception reduces transition work and/or eliminates pretransition losses already computed, the effect of the consistency and revocation rules, and whether planned inbound restructurings could result in gain under Prop. Reg. 1.987-16. Taxpayers also should assess whether to rely on the proposed rules before finalization and coordinate any early adoption across the relevant consolidated and Section 987 electing groups.

Companies should consider providing comments on the proposed regulations, which are due by November 12, 2026.

In detail

Background

The 2024 final regulations generally applied the Section 987 regime to CFCs with Section 987 QBUs, requiring CFCs to compute and recognize foreign currency gain or loss under Section 987(3), including upon remittances and certain QBU terminations. Concurrent 2024 proposed regulations requested comments on whether Section 987(3) instead should be limited or eliminated for CFCs, recognizing both the compliance and administrative burden of the regime and the fact that a CFC may use a non-dollar functional currency, while also identifying a potential for exchange-rate-driven asset basis to enter the United States without a corresponding income inclusion in an inbound liquidation or reorganization.

Notice 2026-17 subsequently announced Treasury and the IRS's intended approach: an elective regime under which CFCs generally would not compute or recognize Section 987 gain or loss, coupled with 120-month amortization of pre-election amounts and a special gain-recognition rule for certain inbound nonrecognition transactions. Notice 2026-17 previewed the framework but did not provide detailed operative rules or permit reliance on the CFC exemption election.

The 2024 final regulations generally permit taxpayers to elect to recognize Section 987 gain or loss arising before the regulations became applicable ('pretransition gain or loss') ratably over a 10-year transition period. Because that approach allocates one-tenth of the amount to each tax year regardless of its length, a short tax year could produce disproportionate recognition. Consistent with Notice 2025-72, the proposed regulations instead would provide that, when the amortization election applies, pretransition gain or loss is recognized ratably over 120 months, so that recognition reflects the actual number of months in each tax year and avoids distortions caused by short periods.

For additional discussion, see PwC Tax Insights on the 2024 final and proposed Section 987 regulations, Notice 2025-72, and Notice 2026-17.

Proposed regulations

CFC exemption election

Overview

The proposed regulations would permit taxpayers to make a CFC exemption election under which Section 987(3) generally would not apply to a CFC and its Section 987 QBUs. As a result, a CFC subject to the CFC exemption election (an 'exempt CFC') generally would not compute or recognize Section 987 gain or loss on ordinary remittances or QBU terminations, unless an inbound nonrecognition transaction occurs (see below). Sections 987(1) and (2), however, would continue to apply for purposes of determining and translating QBU taxable income or loss, including for computing the CFC's taxable income and earnings and profits. The applicable Section 987 rules would be applied as though a current rate election were in effect, eliminating the need to track historic exchange rates.

Observation: The CFC exemption election is a targeted reduction in Section 987(3) compliance rather than a complete exemption from Section 987. Taxpayers would need to continue to maintain the information needed to determine and translate QBU income or loss and to apply the transition and inbound-transaction rules.

Making and revoking the election

The proposed regulations provide flexibility for making the CFC exemption election, but the timing depends on the tax year for which the election is first made.

Tax year	Election timing
Beginning in 2025	Generally, on an original, timely filed (including extensions) return; alternatively, on an amended return filed by October 15, 2027
Calendar year 2026	Generally, on an original, timely filed (including extensions) return
Ending in 2027	Generally, must be made by October 15, 2027
Ending after December 31, 2027	Generally, must be made before the tax year begins
Revocation	Generally, requires IRS consent

A separate rule may permit the election to be made on a timely filed original return (including extensions) for the first tax year in which the CFC exemption election becomes relevant to the taxpayer.

Observation: The election timing rules provide time to evaluate the election, but the limited ability to revoke it makes the decision consequential. Companies should consider expected currency exposures, acquisitions, and restructuring plans over a longer horizon rather than focusing only on current-year compliance savings. Companies also should assess the implications of making the election for 2025 on an amended return, particularly where their 2025 returns are already substantially complete.

Consistency requirements

The CFC exemption election generally must be applied consistently across commonly controlled CFCs and exempt partnerships (see below). The proposed regulations would extend the existing Section 987 electing-group consistency rules to certain affiliated domestic corporations, including related corporations that are not members of the same consolidated group, and would look through domestic partnerships for specified CFC ownership purposes. The proposed regulations contain anti-avoidance rules and transition rules for when a CFC joins a Section 987 electing group. The CFC is deemed to make or revoke the CFC exemption election consistent with the Section 987 electing group. However, Treasury and the IRS continue to study how these rules should apply in acquisitions.

Observation: The consistency requirements apply to a broader population of entities than those included in the Section 987 electing group. For example, the consistency requirements apply to CFCs owned by separate consolidated groups that are owned by a common foreign parent corporation or between domestic corporations that would be members of the same consolidated group but for a partnership breaking consolidation.

Observation: The treatment of an acquired company remains an important open issue, particularly where the buyer and target have different election profiles. Companies should consider submitting comments on this issue.

Effect on partnerships

The CFC exemption election also would extend to certain partnership structures. An exempt CFC generally would not compute or recognize Section 987 gain or loss with respect to an 'exempt partnership QBU.' An exempt partnership QBU generally includes a partnership, an interest in a partnership, or an eligible QBU owned by a partnership, provided it is a Section 987 QBU and is owned either by an exempt CFC or by a partnership for which at least 80% of the capital or profits interests are owned by exempt CFCs in the same controlled group (i.e., an 'exempt partnership'). In addition, Sections 987(1), 987(2), and 989(a) would continue to apply under a reasonable and consistently applied method.

Observation: Each partner, including a *domestic* partner, of an exempt partnership would recognize its share of the exempt partnership's pre-election Section 987 gain or loss over 120 months.

Pre-election Section 987 gain or loss

Under the proposed regulations, an exempt CFC generally would be required to compute pre-election Section 987 gain or loss and recognize that amount ratably over 120 months beginning with the first tax year in which the election applies. The amount includes net unrecognized Section 987 gain or loss, deferred Section 987 gain or loss, and cumulative suspended losses existing immediately before the election.

A significant exception applies to smaller QBUs. A QBU would be treated as having no pre-election Section 987 gain or loss if its average assets for the preceding three tax years are less than $50 million, based on GAAP balance-sheet amounts and subject to same-country aggregation. If the CFC exemption election is made for the first year in which the 2024 final regulations apply, the existing transition rules govern, except smaller QBUs are deemed to have no pretransition amounts, and the 120-month amortization election is deemed made for exempt CFCs' pretransition amounts.

If an ownership transaction causes an exempt CFC to cease to be in the same controlled group as the owner of a successor deferral QBU, or if the election ceases to apply within the first 60 months, certain remaining pre-election losses may become suspended. These rules are intended to limit loss trafficking and short-term use of the election to accelerate losses.

Observation: The $50 million asset-based exception could materially reduce transition work for smaller QBUs, but larger QBUs may still require additional historical computations. The loss-suspension rules also make ownership changes and early revocation relevant to the CFC exemption election analysis.

Inbound nonrecognition transactions

A principal concern with respect to the CFC exemption election is the potential for gain recognition that can result from inbound Section 332 liquidations and Section 368(a)(1) asset reorganizations. If an exempt CFC participates in such a transaction after having been subject to the election for any tax year ending during the 72-month pre-transaction period, it generally must recognize Section 987 gain immediately before the transaction equal to its 'Section 987 asset basis.'

That amount may be determined using either a 72-month lookback methodology based on the simplified transition method or an excess asset basis methodology under Section 367(b). Gain (but not loss) is recognized. A de minimis exception applies if the transferor CFC's inside asset basis is less than $25 million.

Observation: Taxpayers considering inbound restructurings should model both permitted asset basis methodologies and assess the $25 million de minimis rule before implementing the transaction.

Amortization of pretransition gain or loss in a short tax year

Consistent with Notice 2025-72, the proposed regulations would replace the 10-year amortization method with ratable recognition over 120 months, reducing distortions from short tax years and coordinating prior recognized amounts under the 10-year approach.

Observation: The monthly convention may be relevant for transactions that create short tax years and should be modeled separately from the CFC exemption election.

Applicability dates

The proposed regulations provide separate applicability and reliance rules for the CFC exemption election and the revised 120-month amortization rule.

Provision	Timing
CFC exemption election	Applies to tax years ending on or after the date final regulations are filed with the Federal Register; earlier reliance is permitted for tax years beginning after December 31, 2024, subject to consistency requirements
120-month amortization rule	Applies to tax years beginning after December 31, 2024, and ending on or after November 25, 2025 once final regulations are filed with the Federal Register; earlier reliance is permitted for tax years beginning after December 31, 2024, subject to a separate consistency requirement

Observation: The reliance rules could affect current return positions before final regulations are issued; early adoption requires coordinated application across the relevant consolidated and Section 987 electing groups.

Financial reporting considerations

The Section 987 proposed regulations represent new information that should be assessed in the period of issuance, and any resulting impact should be accounted for in that period. The impact of the proposed regulations on a company's financial statements, if any, will depend on the company's intent to rely on the proposed regulations, including its intent with respect to the timing of the CFC exemption election. Accordingly, companies should determine their intent in the reporting period that includes the issuance date of the proposed regulations.

See also

- Tax Insight: Notice 2026-17 charts a simpler Section 987 path with targeted loss relief (March 4, 2026)
- Tax Insight: Treasury releases guidance addressing the repeal of Section 898(c)(2) and the recognition of Section 987 pretransition gain or loss (November 26, 2025)
- Tax Insight: Key highlights of the final and proposed foreign currency regulations (December 19, 2024)

Let's talk

For a deeper discussion of how these proposed regulations might affect your business, please contact:

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