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Notice 2026-17 Simplifies and Resets §987's Evolving Landscape

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Section 987, which addresses currency swings for US taxpayers operating foreign branches, has been a long journey for taxpayers and regulators alike. In many respects, though, the latest update shows that it has been a somewhat circular 35-year path, returning to an approach similar to that originally applied under the 1991 proposed regulations, while making §987 more administrable.

In the beginning, there was an earnings and capital method included in the 1991 proposed regulations. In the early 2000s, proposed regulations introduced a transition toward the Foreign Exchange Exposure Pool, or FEEP, method. In 2016, the journey continued with modifications and final regulations that were ultimately suspended. More recently, new regulations introduced simplifying elections but largely maintained the FEEP framework with certain refinements. Now, the latest notice brings the regime back to its 1991 roots, with an election to apply an earnings and capital methodology.

In this context, the latest administrative guidance reflects a meaningful shift in direction, rather than a wholesale departure from prior approaches, and is best understood as part of a long evolution.

Notice 2026-17, or the “Notice,” announces the IRS’s intent to issue proposed regulations that would substantially simplify the operation of the §987 rules, reduce compliance burdens, and refine the scope of certain rules to limit their effect on ordinary course transactions. Most notably, the Notice signals a return, albeit in modified form, to an elective equity and basis pool methodology that is reminiscent of the 1991 proposed regulations, while also proposing targeted changes to the loss suspension rules, the successor deferral rules, and the definition of §987 hedging transactions.

This article builds on our prior discussion of the §987 transition rules. As we noted in our earlier Tax Management International Journal article, [“How to Decode §987 Transition Rules,”](#) the transition

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framework under Treas. Reg. §1.987-10 serves as the gateway for moving from legacy reasonable method approaches to the now-applicable regulatory regime. Notice 2026-17 does not alter that transition framework. Instead, it materially reshapes the post-transition operating environment in which pretransition balances are tracked and recognized, and it is likely to influence the compliance plans many taxpayers were preparing to implement following the issuance of the 2024 final regulations.

Overview of Notice

The Notice is organized around three sets of anticipated changes. First, §3 describes rules expected to be included in forthcoming proposed regulations providing an election to use an equity and basis pool method that is substantially similar to the 1991 proposed regulations, but with an important operational modification: the replacement of daily remittance tracking with a single annual net remittance computation. Second, §4 proposes refinements that would narrow the scope of the loss suspension rules, simplify the loss-to-the-extent-of-gain regime by collapsing recognition groupings, clarify the definition of a successor for purposes of the deferral rules, and expand the definition of a §987 hedging transaction. Third, §5 previews future guidance providing an election under which controlled foreign corporations, or CFCs, generally would not compute or recognize foreign currency gain or loss under §987(3), except in connection with certain specified inbound transactions.

Taxpayers may rely on the rules described in §3 and §4 for taxable years to which the 2024 final regulations apply and that end before the proposed regulations are published in the Federal Register, provided the rules are applied in their entirety and consistently across the taxpayer's §987 electing group. By contrast, taxpayers may not yet rely on the CFC election previewed in §5. However, the IRS indicated that it intends to issue this guidance soon to provide taxpayers with sufficient time to determine whether to make the CFC election for the 2025 taxable year on an originally filed return (with extension).

For ease of reference, the table below summarizes the principal features of Notice 2026-17 by section, including the anticipated regulatory changes and their current applicability.

Notice 2026-17	Proposed Changes	Applicability
Section 3	Introduces an elective equity and basis pool method, modeled on the 1991 proposed regulations	Taxable years for which the 2024 final Section 987 regulations apply and that end before the proposed regulations are published in the Federal Register, provided those rules are applied in their entirety and consistently across the taxpayer's Section 987 electing group
Section 4	Narrows the application of the loss suspension rules	
	Simplifies recognition groupings for purposes of the loss-to-the-extent-of-gain rule	
	Modifies the definitions of a successor deferral QBU and a Section 987 hedging transaction	
Section 5	Describes a potential future election under which CFCs generally would not be required to compute or recognize foreign currency gain or loss under Section 987(3), except in connection with specified inbound transactions	Not yet available; reliance expected to be permitted upon issuance of future guidance providing the CFC election

The discussion below focuses on those aspects of the Notice that are likely to apply more broadly across taxpayers and does not address certain more targeted or definitional rules described in the Notice.

New Method

The elective equity and basis pool method is the centerpiece of the Notice and the clearest signal of Treasury's current simplification priorities. Under this approach, consistent with the 1991 proposed regulations, a taxpayer maintains an equity pool in the qualified business unit's, or QBU's, functional currency and a basis pool in the owner's functional currency. Section 987 taxable income or loss is determined by computing QBU items in the QBU's functional currency and translating the net amount into the owner's functional currency using the yearly average exchange rate, subject to specified adjustments. Net unrecognized §987 gain or loss at year-end is then computed by comparing the translated equity pool, using the spot rate on the last day of the taxable year, with the basis pool.

The equity and basis pool method would be a §987 election subject to Treas. Reg. §1.987-1(g), made by attaching an election statement to the taxpayer's original, timely filed return for the first taxable year in which the election is effective. The election is available only for taxable years in which a current rate election, or CRE, is in effect. Although this suggests flexibility in the timing of adoption, taxpayers should be mindful that the CRE itself is subject to a 60-month limitation, which may constrain long-term planning.

The Notice illustrates the operation of the equity and basis pool method through a basic example. In the example, US Corp, a calendar-year domestic corporation with the dollar as its functional currency, makes both a CRE under Treas. Reg. §1.987-1(d)(2) and an election to use the equity and basis pool method under §3.02 of the Notice. On July 1 of Year 1, US Corp establishes

Japan Branch, a §987 QBU with the yen as its functional currency. During Year 1, the following transactions occur:

- July 1: US Corp contributes ¥100,000 of cash to Japan Branch (US tax basis of \$1,000).
- July 1: US Corp contributes land to Japan Branch (US tax basis of \$500).
- July 1: Japan Branch borrows ¥10,000 from a third-party bank.
- July 1-December 31: Japan Branch earns ¥12,000 of service revenue and incurs ¥2,000 of related deductible expenses.

Using these facts, the table below walks through the application of the equity and basis pool method, illustrating how contributions, income, expenses, and liabilities affect the equity and basis pools during the taxable year and how net unrecognized §987 gain or loss is determined at year-end.

Year 1 – Japan Branch (¥ Functional Currency)	
Revenue (¥)	12,000
Less: Expenses (¥)	(2,000)
Net Income (¥)	10,000
Average FX Rate (¥ / \$)	110
Section 987 Taxable Income (\$)	91

Year 1 – Equity & Basis Pool Method			
	Equity Pool (¥)	Basis Pool (\$)	Applicable FX Rate
Opening Balance	0	0	
=+ Net Income	10,000	90.91	Average rate (7/1–12/31): \$1 = ¥110
+ Cash Contribution	100,000	1,000.00	July 1 spot rate: \$1 = ¥100
+ Land	50,000	500.00	July 1 spot rate: \$1 = ¥100
Ending Pool	160,000	1,590.91	

Net Unrecognized §987 Gain (Loss)	
Ending Equity Pool (¥)	160,000.00
Spot Rate 12/31 (¥ / \$)	120.00
Translated Equity (\$)	1,333.33
Ending Basis Pool (\$)	1,590.91
Net Unrecognized §987 Loss	(257.58)

Relative to the 1991 proposed regulations, the most administratively significant change is the elimination of daily remittance tracking. By replacing daily remittance computations with a single annual net remittance calculation, the Notice directly addresses one of the most persistent operational challenges to the pool-based approach under the 1991 proposed regulations, particularly for QBUs with frequent intercompany transfers.

The election does not operate as a wholesale exit from the 2024 regulatory framework. While Treas. Reg. §1.987-3 through §1.987-5 would generally not apply, other provisions of the final

regulations, including the transition rules under Treas. Reg. §1.987-10, continue to govern. As a result, where a CRE is in effect, the pretransition gain or loss is treated as net accumulated unrecognized §987 gain or loss under Treas. Reg. §1.987-10(e)(5). If the taxpayer elects to use the equity and basis pool method, the pretransition gain or loss is taken into account in determining the opening basis pool for the taxable year beginning on the transition date, unless the taxpayer elects to recognize pretransition gain or loss ratably over a transition period of 120 months under Treas. Reg. §1.987-10(e)(5)(ii) and Notice 2025-72.

Following the Notice, a §987 QBU owner may determine §987 gain or loss using one of several computation methods, provided the relevant elections are properly made and applicable. These include:

- the full 10-step FEEP method,
- the FEEP method with an annual recognition election, or ARE,
- the modified FEEP method (steps 1 through 5 and step 10) with a CRE,
- the modified FEEP method (steps 1 through 5 and step 10) with a CRE and an ARE,
- the equity and basis pool method described in the Notice with a CRE, and
- the equity and basis pool method with a CRE and an ARE.

Taxpayers that had been preparing to implement the 10-step FEEP method or the modified FEEP method may need to reevaluate that approach in response to the Notice. The central question is no longer whether a system can be built to support FEEP, but whether an equity and basis pool election combined with a CRE offers a simpler and less time-consuming compliance approach. For many taxpayers, the answer may be yes.

Narrowing Loss Suspension

Notice 2026-17 also proposes meaningful, taxpayer-favorable refinements to the loss suspension rules. Under Treas. Reg. §1.987-11(c), in a taxable year in which a CRE applies, §987 losses that would otherwise be recognized upon a remittance generally are treated as suspended §987 losses, or the “CRE loss suspension rule.” The final regulations also contain a separate and frequently overlooked modified loss suspension regime applicable to partnerships and S corporations (the “partnership loss suspension rule”).

Under Treas. Reg. §1.987-11(c)(2), the suspended §987 loss arising under either the CRE loss suspension rule or the partnership loss suspension rule is subject to a de minimis exception tied to a controlled-group-level dollar threshold of \$3 million and a 2%-of-gross-income threshold.

Once suspended, those losses may be recognized only to the extent of §987 gain in the same recognition grouping in the same taxable year or a three-year lookback period.

Under the Notice’s proposed framework, loss suspension would apply to a §987 QBU or a successor deferral QBU only in taxable years in which either the remittance proportion exceeds 5% or the amount of net unrecognized or deferred §987 loss that would otherwise become suspended exceeds \$5 million. Under Treas. Reg. §1.987-5(b)(1), the remittance proportion generally equals the amount of the remittance divided by the aggregate basis of the §987 QBU’s gross assets reflected on its year-end balance sheet (without reduction for the remittance). Where an election to use the equity and basis pool method is in effect, however, the denominator is replaced with the sum of the ending equity pool, the aggregate amount of the §987 QBU’s liabilities, and the amount of the remittance.

This approach replaces the gross-income-based de minimis test with a remittance-focused threshold, increases the dollar threshold to \$5 million, and applies both thresholds on a QBU-by-QBU basis. By tying loss suspension to economically significant remittances and introducing a higher dollar threshold, the revised rules allow routine losses to be recognized without immediate suspension in many cases. In practice, this shift affords taxpayers greater ability to manage loss outcomes through remittance planning—for example, by avoiding large, non-routine remittances that could trigger suspension, rather than having results driven by unrelated fluctuations in gross income or a relatively small threshold when applied at the group level.

The Notice also collapses recognition groupings for purposes of the loss-to-the-extent-of-gain rule. For non-CFC owners, §987 gain and loss would generally be treated as a single recognition grouping. For CFC owners, recognition groupings would be limited to four categories: tentative tested income, a Subpart F income group, effectively connected income excluded from Subpart F, and other income. As a practical matter, particularly for non-CFC owners, the Notice’s single-grouping approach allows losses that otherwise could remain suspended under the final regulations due to the absence of gain in the same recognition grouping to be released. This modification addresses a concern taxpayers have consistently raised regarding administrability and loss utilization under the loss suspension rules.

Excluding §987(3) for CFCs

Finally, §5 of the Notice previews a separate election under which CFCs generally would not compute or recognize foreign currency gain or loss under §987(3), except in connection with specified inbound transactions. Although not yet available for reliance, the election would represent a significant shift for groups with CFC-owned branches. The Notice suggests that the election would be subject to consistency requirements across commonly controlled CFCs and revocable only with IRS consent, with transition rules addressing pre-election unrecognized gain or loss through pro rata recognition over a 120-month period. Taken together, these features suggest that taxpayers should begin evaluating their CFC ownership structures and related-party commonly controlled relationships to assess whether a consistent election would be advantageous. For many taxpayers, the compliance saving from eliminating ongoing §987(3) calculations may outweigh any benefits obtained by occasional foreign currency exchange losses that may have been recognized.

For inbound asset reorganizations or liquidations described in Treas. Reg. §1.367(b)-3(a), the Notice contemplates special rules to account for foreign currency gain (but not loss) that has not been recognized due to the election, by computing a “§987 basis increase.” However, the detailed mechanics of the CFC election and the associated “§987 basis increase” framework for inbound transactions will be provided in future guidance, and the Notice expressly solicits comments on the design and operation of the §987 basis-increase rules.

Key Methodology Differences

Although the computational mechanisms differ, the modified FEEP method with the CRE election in place, or the “CRE FEEP method,” and the equity and basis pool method should generally produce similar gain or loss outcomes in many cases. Differences may arise, however, in certain situations, including during the initial buildup of pools or in cases where the CRE election incorporates residual adjustment mechanisms designed to reflect changes in the value of a QBU’s assets and liabilities, which in certain circumstances may affect the resulting gain or loss. Nevertheless, the two approaches are largely aligned in concept, as both seek to measure §987 gain or loss by reference to overall balance sheet changes, rather than a narrow subset of marked items.

That result stands in contrast to the full FEEP method. Both the CRE FEEP method and the equity and basis pool method looks across the broader balance sheet, including capital

contributions and earnings, whereas the full FEEP method focuses more narrowly on the assets and liabilities that give rise to foreign currency exposure. For that reason, the CRE FEEP method and the equity and basis pool method are often closer to each other than either is to the full FEEP method. The full FEEP method can produce materially different outcomes because it more effectively preserves historic basis for historic assets and liabilities not affected by currency movements and limits exposure to marked items such as cash, receivables, and payables.

As a result, method selection may meaningfully affect outcomes depending on a taxpayer's currency exposure profile. In some circumstances where losses are anticipated, the CRE FEEP method and the equity and basis pool method may generate larger losses due to their broader balance-sheet scope, as compared with the narrower exposure under the full FEEP method. Conversely, in some circumstances where gains are expected, the more limited scope of the full FEEP method may be preferable. The decision is thus a strategic choice that requires taxpayers to weigh expected economic results against the substantial administrability advantages of the CRE FEEP method and the equity and basis pool method.

Final Thoughts

Notice 2026-17 represents a meaningful step toward making §987 administrable without dismantling the 2024 framework. The Notice preserves the transition rules and much of the existing structure while introducing a more practical computation option and meaningful relief from the most restrictive loss-limitation features of the CRE.

In light of these changes, taxpayers should reassess method selection, loss modeling, and election coordination decisions made under the 2024 rules with particular attention to the continuing role of Treas. Reg. § 1.987-10 transition and the operational burden of maintaining consistent, group-wide elections.

At the same time, taxpayers should stay focused on the next phase of §987 guidance. Proposed regulations are expected, and the direction signaled in the Notice suggests that those rules could quickly become relevant for upcoming compliance cycles. Waiting for proposed or final regulations is unlikely to be a practical strategy. The more realistic course is to evaluate the Notice now, model the available methods, and determine which elections best align technical results with operational capacity.

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