INTERNAL REVENUE BULLETIN

Bulletin No. 2026–37
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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

REG-101355-26, page 247.

These proposed regulations provide guidance on employer contributions to Trump accounts under section 128 of the Internal Revenue Code. They also provide guidance on nondiscrimination requirements for purposes of both section 128 Trump account contribution programs and section 129 dependent care assistance programs.

REG-103844-26, page 272.

The Notice of Proposed Rulemaking provides an election under which controlled foreign corporations (CFCs) would not compute or recognize foreign currency gain or loss under section 987(3), except in connection with certain inbound transactions. The proposed regulations would provide that a CFC generally does not compute or recognize section 987 gain or loss for taxable years in which the CFC exemption election is in effect. However, a CFC would be required to recognize section 987 gain or loss arising before the election is made, and would be required to recognize section 987 gain in connection with certain inbound transactions.

REG-115145-25, page 298.

These proposed regulations provide for the allocation of foreign taxes of foreign corporations affected by the repeal of the one-month deferral election. These proposed regulations also provide for the disallowance of foreign tax credits on certain distributions of previously taxed earnings and profits.

Rev. Rul. 2026-17, page 247.

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term tax exempt rate. For purposes of sections 382, 1274, 1288, 7872 and other sections of the Code, tables set forth the rates for September 2026.

Finding Lists begin on page ii.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

Part I

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 467, 468, 482, 483, 1288, 7520, 7702, 7872.)

Rev. Rul. 2026-17

This revenue ruling provides various prescribed rates for federal income tax purposes for September 2026 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2026-17 TABLE 1
Applicable Federal Rates (AFR) for September 2026
Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
		Short-term		
AFR	4.18%	4.14%	4.12%	4.10%
110% AFR	4.60%	4.55%	4.52%	4.51%
120% AFR	5.03%	4.97%	4.94%	4.92%
130% AFR	5.45%	5.38%	5.34%	5.32%
		Mid-term		
AFR	4.49%	4.44%	4.42%	4.40%
110% AFR	4.94%	4.88%	4.85%	4.83%
120% AFR	5.40%	5.33%	5.29%	5.27%
130% AFR	5.85%	5.77%	5.73%	5.70%
150% AFR	6.77%	6.66%	6.61%	6.57%
175% AFR	7.92%	7.77%	7.70%	7.65%
		Long-term		
AFR	5.12%	5.06%	5.03%	5.01%
110% AFR	5.65%	5.57%	5.53%	5.51%
120% AFR	6.16%	6.07%	6.02%	5.99%
130% AFR	6.69%	6.58%	6.53%	6.49%

REV. RUL. 2026-17 TABLE 2
Adjusted AFR for September 2026
Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.16%	3.14%	3.13%	3.12%
Mid-term adjusted AFR	3.40%	3.37%	3.36%	3.35%
Long-term adjusted AFR	3.88%	3.84%	3.82%	3.81%

REV. RUL. 2026-17 TABLE 3	
Rates Under Section 382 for September 2026	
Adjusted federal long-term rate for the current month	3.88%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	3.88%

REV. RUL. 2026-17 TABLE 4	
Appropriate Percentages Under Section 42(b)(1) for September 2026	
Note: Under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%.	
Appropriate percentage for the 70% present value low-income housing credit	8.12%
Appropriate percentage for the 30% present value low-income housing credit	3.48%

REV. RUL. 2026-17 TABLE 5	
Rate Under Section 7520 for September 2026	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.40%

Section 42.—Low-Income Housing Credit

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2026. See Rev. Rul. 2026-17, page 247.

Section 280G.—Golden Parachute Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2026. See Rev. Rul. 2026-17, page 247.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of September 2026. See Rev. Rul. 2026-17, page 247.

Section 467.—Certain Payments for the Use of Property or Services

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2026. See Rev. Rul. 2026-17, page 247.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The applicable federal short-term rates are set forth for the month of September 2026. See Rev. Rul. 2026-17, page 247.

Section 482.—Allocation of Income and Deductions Among Taxpayers

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2026. See Rev. Rul. 2026-17, page 247.

Section 483.—Interest on Certain Deferred Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2026. See Rev. Rul. 2026-17, page 247.

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2026. See Rev. Rul. 2026-17, page 247.

Section 7520.—Valuation Tables

The applicable federal mid-term rates are set forth for the month of September 2026. See Rev. Rul. 2026-17, page 247.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2026. See Rev. Rul. 2026-17, page 247.

Part IV

Notice of Proposed Rulemaking

Employer Contributions to Trump Accounts and Nondiscrimination Rules for Dependent Care Assistance Programs

REG-101355-26

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that would provide guidance with respect to employer contributions to Trump accounts, including applicable nondiscrimination rules, and the nondiscrimination rules for dependent care assistance programs. This document also provides a notice of a public hearing on the proposed regulations. The proposed regulations would affect employers maintaining a Trump account contribution program or a dependent care assistance program and employees participating in those programs.

DATES: Comments: Electronic or written comments must be received by September 25, 2026. Public Hearing: The public hearing is scheduled to be held on October 15, 2026 at 10 a.m. ET. Requests to speak and outlines of topics to be discussed at the public hearing must be received by September 25, 2026. If no requests to speak or outlines are received by September 25, 2026, the public hearing will be cancelled. Requests to attend the public hearing must be received by 5 p.m. ET on October 13, 2026.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG-101355-26) by following the online instructions for submitting comments. Requests for the public hearing must be submitted as prescribed in Comments and Public Hearing in Part V of this preamble. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments submitted to the IRS's public docket. Send paper submissions to: CC:PA:01:PR (REG-101355-26), room 5503, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jennifer Friedman at (202) 317-5500; concerning submissions of comments and the public hearing, the Publications and Regulations Section at (202) 317-6901 (not toll-free numbers) or by email at *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

I. Authority

This document contains proposed additions to the Income Tax Regulations (26 CFR part 1) to implement sections 128 and 129 of the Internal Revenue Code (Code).

These proposed regulations are promulgated under section 7805(a) of the Code, which provides that "the Secretary[1] shall prescribe all needful rules and regulations for the enforcement of [the Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue."

II. Background

A. *In General*

1. Section 128 Contributions to Trump Accounts

Section 70204 of Public Law 119-21, 139 Stat. 72 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA), added section 530A regarding Trump accounts to the Code. Section 70204 of the OBBBA also added section 128 to the Code providing an exclusion from gross income for employer contributions to the Trump account of an employee or of any dependent of an employee pursuant to a Trump account contribution program. The provisions apply to taxable years beginning after December 31, 2025.

A Trump account is a type of traditional individual retirement account (IRA) that is established for the exclusive benefit of an eligible individual and that is designated at its establishment as a Trump account. When a Trump account is opened, the eligible individual is the owner of the Trump account and is referred to as the account beneficiary.

A Trump account is subject to certain special rules inapplicable to other individual retirement arrangements under section 408.[2] The special rules apply only during the period that begins when the account beneficiary's initial Trump account is established and ends on December 31 of the calendar year in which the account beneficiary attains age 17 (growth period). The special rules that apply only during the growth period include rules regarding contributions, investments, distributions, and reporting. After the growth period, most of these special rules cease to apply and the rules under section 408(a) governing traditional IRAs generally apply.

Section 128(a) provides that an amount paid by an employer as a contribution to

[1] Section 7701(a)(11)(B) provides that the term "Secretary" means the Secretary of the Treasury or his delegate. Section 7701(a)(12)(A)(i) defines delegate to include any agency of the Treasury Department, which includes the IRS.

[2] Individual retirement arrangements are individual retirement accounts under section 408(a) or individual retirement annuities under section 408(b). The term "individual retirement arrangements" refers to both individual retirement accounts and individual retirement annuities, while the term "IRAs" refers only to individual retirement accounts under section 408(a).

the Trump account of an employee or of any dependent of an employee pursuant to a Trump account contribution program is excludable from gross income of the employee.

Section 128(b) provides that the amount excludable under section 128(a) with respect to any employee shall not exceed $2,500 (subject to inflation adjustments after 2027).

Section 128(c) provides that the term "Trump account contribution program" means a separate written plan of an employer for the exclusive benefit of its employees to provide contributions to the Trump accounts of such employees or dependents of such employees that meets requirements similar to the requirements of section 129(d)(2), (3), (6), (7), and (8).

2. Section 129 Dependent Care Assistance Programs

Section 129[3] provides that amounts paid or incurred by an employer for dependent care assistance provided to an employee are excludable from the employee's gross income if the amounts are furnished pursuant to a dependent care assistance program. A dependent care assistance program is a separate written plan of an employer for the exclusive benefit of its employees that provides dependent care assistance and meets certain other requirements under the Code, including requirements relating to nondiscriminatory benefits, limits on principal shareholders' benefits, and information to be provided to eligible employees.

Dependent care assistance means the payment or provision of services that would be considered employment-related expenses under section 21(b)(2) (relating to expenses for household and dependent care services necessary for gainful employment) if paid for by the employee. Such employment-related expenses include expenses for the care of a qualifying individual. The term "qualifying individual" is defined as (i) a dependent of the taxpayer who has not attained age 13 or (ii) a dependent or spouse of the taxpayer who is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than one-half of the taxable year. The amount that may be excluded annually from an employee's gross income under a dependent care assistance program is limited to $7,500 ($3,750 in the case of a married individual filing a separate return).

A dependent care assistance program must satisfy four nondiscrimination rules: (1) the contributions and benefits rule in section 129(d)(2), (2) the eligibility rule in section 129(d)(3), (3) the owner concentration rule in section 129(d)(4), and (4) the average benefits rule in section 129(d)(8). The contributions and benefits rule is satisfied if the contributions and benefits provided under the plan do not discriminate in favor of highly compensated employees (HCEs) within the meaning of section 414(q). The eligibility rule is satisfied if a plan must benefit employees who qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of HCEs or their dependents. The owner concentration rule is satisfied if no more than 25 percent of the amounts paid or incurred by the employer for dependent care assistance during the year are provided for the class of individuals who are shareholders or owners (or their spouses or dependents), each of whom (on any day of the year) owns more than 5 percent of the stock or of the capital or profits interest in the employer. The requirements of the average benefits rule are satisfied if the average benefits provided to employees who are not HCEs under all plans of the employer is at least 55 percent of the average benefits provided to the HCEs under all plans of the employer. A special rule applies with respect to benefits provided through a salary reduction agreement that allows the plan to disregard employees whose compensation is less than $25,000.

In applying the eligibility test and the average benefits test, employees are excluded if they have not attained age 21 and completed one year of service; or if they were not included in a dependent care assistance program and were included in a unit of employees covered by a collective bargaining agreement under which dependent care benefits were the subject of good faith bargaining.

If a dependent care assistance program fails the nondiscrimination rules, the benefits are not excludable from income by HCEs, but the benefits are excludable from income by employees who are not HCEs.

B. *Published Guidance*

Notice 2025-68, 2025-52 IRB 856, informed taxpayers that the Treasury Department and the IRS intend to propose regulations providing guidance with respect to Trump accounts. The notice described guidance expected to be included in the proposed regulations in the form of answers to specific questions, including questions about employer contributions under a Trump account contribution program.

Notice 2025-68, Q&A I-1 states that section 128 permits an employee to exclude up to $2,500 per calendar year, indexed for inflation after 2027, for employer contributions made under a Trump account contribution program. This limit is applied per employee rather than per dependent, so an employee with multiple children still has only one aggregate $2,500 exclusion. Q&A I-2 of Notice 2025-68 states that when an employer makes a section 128 contribution to a Trump account, it must affirmatively identify the payment to the trustee of the Trump account as a section 128 contribution that is excludable from the employee's income, and the trustee may rely on that employer-provided information unless it has contrary knowledge.[1] Finally, Q&A I-3 of Notice 2025-68 states that a Trump account contribution program may be offered through salary reduction under a section 125 cafeteria plan only when the contribution is made to the Trump account of the employee's dependent, not to the employee's own Trump account.

Notice 2025-68 included a request for comments. These proposed regulations under sections 128 and 129 are informed

[3] Section 129 was originally added to the Code by the Economic Recovery Tax Act of 1981 (Pub. L. 97-34) and has been amended several times.

[4] Note that section 408(h) provides, "For purposes of this title, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof."

by the comments received in response to the notice. The issues raised in the comments are discussed in the Explanation of Provisions in Part III of this preamble.

III. Explanation of Provisions

A. *Section 128 Contributions to Trump Accounts*

Proposed § 1.128-1(h) would define a section 128 contribution as an amount paid by an employer to a Trump account under a Trump account contribution program.

1. Trump account contribution program

Proposed § 1.128-1(j) would define the term Trump account contribution program to mean a program governed by a separate written plan of an employer for the exclusive benefit of its employees to provide contributions to the Trump accounts of the employees or their dependents that meets the requirements of proposed § 1.128-2(b) through (h), including following the terms of the written plan, satisfying the nondiscrimination requirements (see Part III.B. of this preamble), and providing various notices and certifications. For these purposes, the term Trump account has the meaning set forth in section 530A(b)(1). Generally, an arrangement that fails to satisfy a requirement for a Trump account contribution program would not be a Trump account contribution program and, for this reason, contributions to Trump accounts under such an arrangement would not be excludable from employee income under section 128. However, with respect to the nondiscrimination requirements at proposed § 1.128-3, a failure to satisfy the rules would cause the arrangement to fail to be a Trump account contribution program only with respect to HCEs.

a. Written plan

Proposed § 1.128-2(b) would provide that a Trump account contribution program must be set forth in a separate written plan. The written plan must specify—(i) the classes of employees eligible to participate; (ii) the rules governing employer contributions, including the amount of contributions and whether contributions may be made via a section 125 cafeteria plan salary reduction arrangement; (iii) the procedures under which an employee must designate the Trump account of the employee or of a dependent of the employee to receive contributions; (iv) the certification, notice, and reporting procedures required under proposed § 1.128-2(d), (f) and (g); (v) the plan year; and (vi) the procedures for correcting administrative failures and for furnishing notices to employees and trustees when amounts previously designated as section 128 contributions are subsequently determined not to be excludable from an employee's gross income under section 128(a). Proposed § 1.128-2(c) would provide that an arrangement is a Trump account contribution program only if the employer follows the terms of the written plan.

b. Reasonable notification

Under section 128(c), a Trump account contribution program must meet requirements similar to the requirements of section 129(d)(6), which requires reasonable notification of the availability and terms of the program to be provided to eligible employees. Accordingly, proposed § 1.128-2(f) would provide that all eligible employees must be given reasonable notification of the availability and terms of the Trump account contribution program. This rule is intended to ensure that employees who are eligible to participate are adequately informed by the employer about the existence of the program and the terms governing participation. Providing reasonable notification is also relevant to the operation of the eligibility rules, because employees cannot have a meaningful opportunity to receive benefits under the program unless they are informed by the employer that the program is available and understand its basic terms. Proposed § 1.128-2(f) does not prescribe content requirements or a particular method of furnishing the notice.

c. Written statement

Under section 128(c), a Trump account contribution program must meet requirements similar to the requirements of section 129(d)(7), which requires a plan to furnish to an employee, on or before January 31, a written statement showing the amounts paid or expenses incurred by the employer in providing dependent care assistance to the employee during the previous calendar year. Accordingly, proposed § 1.128-2(g) would provide that a written statement showing the amount of section 128 contributions made for an employee during the previous calendar year under the employer's Trump account contribution program must be furnished to that employee. This requirement may be satisfied by including the amount of Trump account contributions on the employee's Form W-2, *Wage and Tax Statement*, in the manner specified in the form's instructions for reporting section 128 contributions. The 2026 General Instructions for Forms W-2 and W-3 provide that the employer must report the amount of section 128 contributions made to the Trump account of an employee or dependent of an employee in box 12 of the Form W-2 with code TA.

d. Certification

Proposed § 1.128-2(d)(1) would provide that a Trump account contribution program may make contributions only to a Trump account whose account beneficiary is in his or her growth period, and is an employee or an employee's dependent. Proposed § 1.128-2(d)(2) would provide that the aggregate amount contributed with respect to any employee under a Trump account contribution program may not exceed the permitted annual limit specified in proposed § 1.128-2(d)(5). Proposed § 1.128-2(d)(3) would provide that contributions that are not permitted under proposed § 1.128-2(d)(1) or (d)(2) are not made pursuant to a Trump account contribution program and thus are not excludable from income under proposed § 1.128-2(a).

Proposed § 1.128-2(d)(4) would allow, but not require, an employer to rely on certain employee certifications. The employee certification must be in writing, in paper or electronic form, and must include the following representations: (i) the account beneficiary is the employee or anticipated to be the dependent of the employee for that employee's taxable year during which the contribution is made; (ii) the beneficiary's date of birth, which would allow the employer to determine whether the beneficiary is in his or her growth period for the calendar year in which the contribution is made; and (iii) no facts are known to the employee that would make the account beneficiary ineligible to receive a contribution to his or her Trump account for that calendar year. The employer may rely on this certification unless the employer has actual knowledge that the certification is incorrect.

Proposed § 1.128-2(d)(4) would further provide that an employer may not rely solely on an employee certification to establish that the recipient account is a valid Trump account. The employer must use a method reasonably designed to verify, through information provided by the trustee, payroll processor, or other service provider, that the contribution is made to a valid Trump account. For example, the method may be that the employee provides the employer with a unique identifying number that corresponds to a particular Trump account, which the employer (or service provider) could then use to verify that the account to which the contribution will be transferred is a valid Trump account. The Treasury Department and the IRS are exploring ways in which this information can be validated in a secure, electronic way.

e. Employer communication

Proposed § 1.128-2(h) would prescribe rules regarding employer communications with a Trump account trustee to which the employer is making contributions. Proposed § 1.128-2(h)(1) would require an employer at the time it makes a contribution to a trustee to advise the trustee that the amount is a section 128 contribution.

If the employer subsequently determines a section 128 contribution not to be a section 128 contribution, in whole or in part, proposed § 1.128-2(h)(4) would require an employer to so notify the trustee and provide the trustee with the affected Trump account information, the calendar year in which the contribution was made, and the amount determined not to be a section 128 contribution. The employer must provide this notice within a reasonable period of time following the date the employer determines that an amount is not a section 128 contribution. Proposed § 1.128-2(h)(4) would deem 21 calendar days after the determination to be a reasonable period of time as a safe harbor.

The Treasury Department and the IRS request comments on whether any additional information is needed for this corrective notice requirement.

Proposed § 1.128-2(h)(2) would require an employer to adopt procedures to ensure that section 128 contributions are properly identified and to notify the trustee when a contribution is a section 128 contribution and when a contribution previously identified as a section 128 contribution is not a section 128 contribution. Proposed § 1.128-2(h)(3) would allow a Trump account trustee to rely on an employer's notice that an amount is a section 128 contribution until such time that the trustee receives a corrective notice or has contrary knowledge.

The Treasury Department and the IRS propose this rule to ensure that contributions intended to qualify as section 128 contributions are specifically identified as section 128 contributions when made and are corrected as necessary, so that the trustee may properly administer the contribution under the applicable rules governing Trump accounts, including properly accounting for whether the account beneficiary has basis in such contributions. The Treasury Department and the IRS recognize that the corrective notice requirement may be operationally challenging. For this reason, comments are requested on what elements in particular will be difficult to effectuate, and alternative ways to ensure that basis in Trump accounts may be properly accounted for where section 128 contributions are recharacterized. For example, the Treasury Department and the IRS ask commenters to consider whether it would be viable for the employer to furnish a notice to the affected employee that could be submitted to, and relied upon by, the trustee of the affected account.

f. Trustee selection

Comments received in response to Notice 2025-68 requested guidance on whether an employer may limit the number of trustees of Trump accounts to whom they will send contributions under a Trump account contribution program. Some commenters explained that allowing such limitations could minimize employer burden associated with directing contributions to multiple trustees as Trump accounts are established or rolled over.

Proposed § 1.128-2(d)(6) would provide that an arrangement is not a Trump account contribution program if an employer limits contributions to Trump accounts held by a particular trustee or trustees. Allowing for a Trump account contribution program to restrict the trustee or trustees would frustrate the purposes of section 128 and section 530A because, unlike analogous circumstances involving health savings accounts, only one Trump account may exist for a particular beneficiary. If the employer were permitted to select the trustees into which a section 128 contribution would be made, an employee whose dependent has a Trump account with a different trustee would be precluded from receiving contributions to the dependent's Trump account. In addition, in the case of parents working for different employers, each of whom limits section 128 contributions to particular, but different trustees, at least one parent would be precluded from receiving tax-favored employer contributions to the dependent's Trump account. Section 530A(b)(1)(A)(i), which contemplates the Treasury Department's role in organizing initial Trump accounts, supports the need for a rule that addresses systemic account structure problems that arise because only one Trump account may exist for a beneficiary. Trump accounts are a distinct statutory arrangement, not merely ordinary IRAs by another name, and the Treasury Department's general rulemaking authority under section 7805 supports issuance of administrable rules implementing sections 128 and 530A where the statute leaves operational gaps. Accordingly, the proposed regulations would provide that a Trump account contribution program may not restrict contributions to a particular trustee or trustees.

2. Salary reduction

Consistent with Notice 2025-68, proposed § 1.128-2(d)(7) would provide that a Trump account contribution program may allow an employee to make a contribution via salary reduction under a section 125 cafeteria plan if the contribution is made to the Trump account of the employee's dependent but not if the contribution is made to the Trump account of the employee. Although a Trump account contribution program would be a qualified benefit under section 125(f)(1), a contribution under the Trump account contribution program to a Trump account of the employee would provide deferred compensation that is prohibited under section 125(d)(2)(A), because the employee would have a vested right to compensation that may be payable to that individual in a later year. In contrast, in the case of a contribution to the Trump account of a dependent, the employee cedes dominion and control over the contributed amount after the contribution is made, retaining no future right to receive or assign later distributions from the account. In the case of a contribution to the account of a dependent, the amount is not a deferral of a right to compensation because there is no such future right.

Comments received in response to Notice 2025-68 that addressed salary reduction through a section 125 cafeteria plan generally described it as an important feature because it would let employees make pre-tax contributions to a dependent's Trump account, something they otherwise could not do. Several commenters treated this as a potentially meaningful path to employer adoption. One commenter asked for clarification regarding whether the elections would be required before the start of the program year or if employees could change or revoke their elections mid-year.

Proposed § 1.128-2(d)(7) would provide that a section 125 cafeteria plan may permit employees to make prospective salary reduction elections, or to change or revoke those elections, at any time during the plan year, provided the election change is effective before the salary becomes currently available. Proposed § 1.128-2(d)(7) would also require that the section 125 cafeteria plan specifically describe the Trump account program contribution benefit and permit participants to prospectively change or revoke elections at least monthly before salary becomes currently available. The Treasury Department and the IRS propose these regulations to facilitate administration of section 128 contributions through section 125 cafeteria plans while ensuring that any election to reduce salary remains prospective in operation. The Treasury Department and the IRS intend to amend Treas. Reg. § 1.125-4 to incorporate these proposed rules concerning election changes with respect to salary reduction for section 128 contributions.

3. Annual limitation

Proposed § 1.128-2(d)(5) would provide that, with respect to any employee, the total contributions under a Trump account contribution program for a calendar year may not exceed the lesser of the amount specified in section 128(b), as adjusted for inflation under section 128(b)(2), or the amount specified in the terms of the program's written plan.

An individual employee may not exclude employer contributions under section 128 for that individual's taxable year to the extent the aggregate amount of such contributions from all employers exceeds the annual limitation under section 128(b). Specifically, proposed § 1.128-2(d)(5) would provide that the amount which may be excluded by an individual with respect to all Trump account contribution programs for that individual's taxable year may not exceed the amount specified in section 128(b), which is $2,500 for 2026 and 2027 and is adjusted for taxable years after 2027 as provided in section 128(b)(2). An employee's receipt of excess contributions due to participation in Trump account contribution programs sponsored by more than one employer will not cause those programs to fail to be Trump account contribution programs, provided that each program prohibits the payment of contributions under that plan with respect to an employee in excess of the annual limitation.

Several comments received in response to Notice 2025-68 requested that the Treasury Department and the IRS clarify how the annual limit for employer contributions applies in certain scenarios where multiple employers might make contributions to the same Trump account or an employee has multiple children who could receive contributions to their Trump accounts under an employer's Trump account contribution program. In response to these comments, proposed § 1.128-2(d)(5)(ii) would clarify that the annual limit applies with respect to each employee so that if an employee has more than one employer in a year, the maximum that an employee can receive from all employers is the amount specified in section 128(b). Further, as to employment for a single employer, the limit applies to the employee rather than on a dependent-by-dependent basis. If an employee has more than one dependent with a Trump account, a program may permit the contribution to be allocated among those accounts, provided that the aggregate amount an employer contributes with respect to the employee for the calendar year does not exceed the annual limit. The proposed regulations provide examples clarifying the application of these rules.

A number of major employers have announced their intention to match the government's $1,000 contributions pursuant to the section 6434 Trump accounts contribution pilot program for eligible children born in the years 2025 through 2028. Provided that the arrangement otherwise qualifies as a Trump account contribution program under section 128, these employer contributions would be excludable from employee gross income. Like other section 128 contributions, the match contributions would count toward the program's limit under proposed § 1.128-2(d)(5) and toward the individual employee's aggregate limit under section 128(b) for the taxable year. See Part B.7 of this Explanation of Provisions for a safe harbor for such match contributions under the otherwise applicable nondiscrimination rules that would apply under proposed § 1.128-3.

Proposed § 1.128-2(d)(5)(v) would provide that an employer has no obligation with respect to compliance with the section 530A(c)(2) limit. The Treasury Department and the IRS intend to provide in a separate notice of proposed rulemaking addressing contributions to a Trump account that, to the extent that section 128 contributions and other source contributions (such as from the parent, child, relative, etc. but not including pilot program contributions, qualified general contributions, or qualified rollover contributions) are made to a Trump account and exceed the section 530A(c)(2) annual limit, excess contributions will be considered first to be attributable to the other source contributions before being attributable to section 128 contributions. The Treasury Department and the IRS request comments on specific circumstances in which the section 128 contributions in addition to other contributions to a Trump account may exceed the applicable limit under section 530A and how such situations can best be addressed.

The Treasury Department and the IRS note that an employer may make contributions to a Trump account that are not section 128 contributions because, for example, the contribution exceeds the annual limit for contributions that are excludable from gross income under a Trump account contribution program. Pursuant to section 219(f)(5), amounts paid by an employer on behalf of an employee to a Trump account that are not made under a Trump account contribution program, including by reason of exceeding the annual limit, are not excludable from income by virtue of section 128, and absent some other basis for exclusion, are payments of compensation to the employee that are includible in his or her gross income and wages in the taxable year for which the amounts were contributed and are subject to applicable employment tax reporting and withholding. For example, if an employer contributes an additional amount outside of the Trump account contribution program to a Trump account, it must treat that amount as gross income and wages to the employee rather than as a section 128 contribution. Proposed § 1.128-2(d)(5)(vi)(E) (*Example 5*) illustrates this rule.

4. Employer and employee

For an amount to be excludable from gross income under section 128, it must be contributed by an employer to the Trump account of an employee or an employee's dependent. One comment received in response to Notice 2025-68 asked Treasury and the IRS to address whether section 128 contributions may be made for an "owner-employee," specifically in the case of partners in a partnership and S corporation shareholders.

To address this comment proposed § 1.128-1(b) would provide that the term employee means an individual who is an employee under the common-law standard described in § 31.3401(c)-1. Therefore, the term employee does not include a self-employed individual within the meaning of section 401(c)(1), such as a partner in a partnership, a sole proprietor, a director solely by reason of service as a director, or a 2-percent shareholder of an S corporation within the meaning of section 1372(b). A self-employed individual is not disqualified from maintaining a Trump account contribution program covering employees of the self-employed individual's trade or business, but the self-employed individual would not be eligible to participate in the program.

This definition is narrower than the definition of employee in section 129 and is based on differences in the statutory structures of the two provisions. Section 128 does not define the term "employee." Accordingly, in the absence of a contrary statutory indication, that term is interpreted under common-law principles. *See Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322-24 (1992). Section 129 similarly does not provide a general definition of employee and thus would also rely on common law principles. In contrast to section 128, however, section 129(e)(3) states the term employee includes "an individual who is an employee within the meaning of section 401(c)(1) (relating to self-employed individuals)." Section 129(e)(3) is not among the paragraphs of section 129 that are incorporated into section 128. Moreover, section 128 does incorporate three of the four nondiscrimination provisions of section 129(d), omitting only section 129(d)(4), which tests owner concentration, a rule that is generally unnecessary when self-employed individuals, including owners in that capacity, are not eligible for the benefit. Accordingly, the statutory structure indicates that self-employed individuals were intentionally excluded from section 128.

Likewise, consistent with the proposed definition of employee, proposed § 1.128-1(c) would define employer by reference to the common-law standard. The proposed regulations would further provide that all persons treated as a single employer under section 414(b), (c), (m), or (o) are treated as a single employer for purposes of section 128. Although these rules are not referenced expressly in section 128, they are implicitly incorporated into section 128 because the section 129 rules referenced in section 128(c) are subject to them by virtue of section 414(t). As a result, in adopting rules similar to the referenced section 129 rules, as section 128(c) directs, it is appropriate to incorporate the same aggregation rules. Accordingly, the proposed regulations would treat related entities that are members of a controlled group of corporations, trades or businesses under common control, or an affiliated service group, or that otherwise are required to be aggregated under section 414(o), as one employer in applying section 128(c). The rules are intended to function under section 128 in the same manner as they would under section 129, including the application of special rules for separate lines of business under section 414(r).

5. Dependent

Proposed § 1.128-1(a) would define dependent for purposes of section 128 by cross-reference to the definition of dependent in section 152.[5] Consequently, in the case of divorced or separated parents, or married taxpayers filing separately, a child cannot qualify as a dependent of both parents and only one of the parents can claim the child as a dependent. See section 152(c)(4) and (e). In the case of a married couple filing jointly, a child may qualify as a dependent of both parents for purposes of the exclusion under section 128.

6. Exclusion from gross income

Proposed § 1.128-2(a) would provide that gross income of an employee does not include an amount paid by the employer as a contribution to the Trump account of the employee or of any dependent of the employee pursuant to a Trump account contribution program. Such a contribution may be made via salary reduction, as explained in Part A.2 of this Explanation

[5] As provided in section 152(a), the definition of dependent in section 152 applies for purposes of subtitle A of the Code, which includes section 128.

of Provisions.[6] Amounts contributed by an employer in excess of the section 128 exclusion, or otherwise not meeting the requirements for exclusion under section 128, would not be excludable from the employee's gross income under section 128.

Several comments received in response to Notice 2025-68 asked for clarification regarding whether employer contributions under a Trump account contribution program are wages subject to the Federal Insurance Contributions Act (FICA), Railroad Retirement Tax Act (RRTA), and Federal Unemployment Tax Act (FUTA), as well as Federal income tax withholding requirements. Although section 128 excludes certain employer contributions from an employee's gross income for Federal income tax purposes, that exclusion does not extend to amounts that are taxed as wages under subtitle C of the Code. Thus, employer contributions that are excludable from gross income under section 128 have no corresponding exclusion from the definitions of wages under section 3121 (FICA) and section 3306 (FUTA), or compensation under section 3231 (RRTA), and are treated as wages or compensation for these purposes unless some other exclusion applies. Although there is also no express exclusion from the definition of wages under section 3401 for section 128 contributions, Federal income tax withholding generally is intended to be commensurate with an employee's income tax liability. Therefore, section 128 contributions that are excludable from an employee's income will not be treated as subject to Federal income tax withholding. *See, e.g.,* Notice 2001-14, 2001-6 IRB 516.

B. *Nondiscrimination Rules*

As discussed previously, section 128 provides that Trump account contribution programs must, among other things, satisfy "requirements similar to the requirements" of certain of the nondiscrimination rules under section 129. In general, the nondiscrimination rules under proposed §§ 1.128-3 and 1.129-2 are identical. However, these proposed regulations would differ with respect to the nondiscrimination rules in situations in which modifications would better effectuate the purposes of section 128.

Proposed § 1.129-1 would provide certain definitions related to dependent care assistance programs. Proposed §§ 1.128-3 and 1.129-2 would clarify the application of the nondiscrimination rules to Trump account contribution programs and dependent care assistance programs, respectively.

Comments received in response to Notice 2025-68 expressed support for comprehensive section 129 guidance that provides clear and administrable rules. Some commenters requested that safe harbors or other interim relief be provided in order to ensure that uncertainty does not discourage employers from implementing Trump account contribution programs. Commenters also raised unresolved questions about the definition of an HCE, what it means for "benefits or contributions" not to discriminate in favor of HCEs, and how the section 129(d)(3) classification test should work. They also emphasized that the 55-percent average benefits test under section 129(d)(8) has been the subject of confusion for many years and has been challenging for taxpayers to apply. Commenters also requested that the Treasury Department and the IRS provide guidance on opportunities for remediation and self-correction of contributions that would otherwise cause a nondiscrimination failure.

1. Definition of HCEs

For purposes of both sections 128 and 129, HCE is defined by cross-reference to section 414(q). Proposed §§ 1.128-1(f) and 1.129-1(a)(7) would define non-highly compensated employee (NHCE) to mean an employee who is not an HCE. These definitions would provide the basic employee groupings used throughout the proposed nondiscrimination rules under both sections 128 and 129. The Treasury Department and the IRS propose these regulations to provide an administrable framework for applying the statutory requirement that eligibility classifications not discriminate in favor of HCEs, while aligning the analysis under sections 128 and 129 with established nondiscrimination principles used in other employee benefit contexts.

2. Contributions and benefits

Proposed §§ 1.128-3(a) and 1.129-2(a) would provide parallel rules requiring that contributions and benefits provided under the Trump account contribution program and dependent care assistance plan, respectively, must not discriminate in favor of HCEs or their dependents. These proposed regulations would implement section 129(d)(2) (applied to Trump account contributions via section 128(c)) through qualitative rules governing the terms on which contributions are made available under the program. More specifically, proposed §§ 1.128-3(a) and 1.129-2(a) would provide that a Trump account contribution program or dependent care assistance program does not satisfy the nondiscrimination rule for contributions and benefits if the program provides more favorable terms for HCEs than for other employees. These proposed regulations would further provide that a program satisfies this requirement if it is designed to provide contributions and benefits on the same terms for all employees who are eligible to participate, even if eligible employees receive different amounts of contributions and benefits as a result of differing elections or differing utilization of the contributions and benefits.

3. Eligibility

Proposed §§ 1.128-3(b) and 1.129-2(b) would address the requirement in sections 128(c) and 129(d)(3), respectively, that the program benefit employees who qualify under a classification established by the employer and found by the Secretary not to be discriminatory in favor of HCEs or their dependents. Proposed §§ 1.128-3(b) and 1.129-2(b) would inter-

[6] The Treasury Department and the IRS note that employers may not provide section 128 contributions directly to the employee or employee's dependent; rather, the contributions must be made to Trump accounts.

pret these provisions as requiring both that the employer's eligibility classification be reasonable and that the classification be nondiscriminatory in operation.

Accordingly, proposed §§ 1.128-3(b)(2) and 1.129-2(b)(2) would provide that an eligibility classification must be, based on all facts and circumstances, reasonable and established under objective business criteria that identify the category of employees who are eligible under the program. Proposed §§ 1.128-3(b)(2) and 1.129-2(b)(2) would clarify that reasonable classifications generally include specified job categories, nature of compensation (salaried or hourly), geographic location, and similar bona fide business criteria, but that an enumeration of employees by name, or by criteria having substantially the same effect, is not a reasonable classification. This is the same standard that is applied under § 1.410(b)-4(b).

Proposed §§ 1.128-3(b)(3) and 1.129-2(b)(3) would further provide rules for determining whether an employer's eligibility classification is nondiscriminatory. Under the proposed regulations, a classification would be nondiscriminatory for a plan year only if the group of employees eligible under the program satisfies either a facts-and-circumstances test or a numerical safe harbor, both of which are similar to the nondiscriminatory classification test for qualified plans described in § 1.410(b)-4.

Proposed §§ 1.128-3(b)(3)(ii) and 1.129-2(b)(3)(ii) would provide a facts-and-circumstances test for determining whether an employer's eligibility classification is nondiscriminatory. Under proposed §§ 1.128-3(b)(3) and 1.129-2(b)(3), a classification would satisfy the eligibility requirement if and only if, based on all the relevant facts and circumstances, the Secretary finds that the classification is nondiscriminatory. Proposed §§ 1.128-3(b)(3)(ii) and 1.129-2(b)(3)(ii) would clarify that no one factor is determinative and would identify relevant considerations including the underlying business reason for the classification, the percentage of the employer's employees who are eligible under the plan, whether the eligible employees under the plan are representative of the employer's workforce across salary ranges, and the extent to which the plan's ratio percentage differs from the employer's safe harbor percentage (as described in the following paragraph). In general, the greater the business justification for the classification, the broader the coverage under the plan, the more representative the classification is across salary ranges, and the smaller the difference between the plan's ratio percentage and the employer's safe harbor percentage, the more likely the classification is to be nondiscriminatory. The Treasury Department and the IRS propose these regulations to provide a flexible but administrable standard for evaluating classifications that do not satisfy the numerical safe harbor while ensuring that the classification does not discriminate in favor of HCEs or their dependents.

Proposed §§ 1.128-3(b)(3)(iii) and 1.129-2(b)(3)(iii) would provide a safe harbor under which the classification would be treated as nondiscriminatory if the plan's ratio percentage is greater than or equal to the safe harbor percentage of the employer. Proposed §§ 1.128-3(b)(3)(iii) and 1.129-2(b)(3)(iii) would define the plan's ratio percentage by comparing the percentage of NHCEs who are eligible under the program to the percentage of HCEs who are eligible under the program. The proposed regulations would define the safe harbor percentage of an employer as 90 percent, reduced by 3/4 of a percentage point for each whole percentage point by which the NHCE concentration percentage exceeds 60 percent. The NHCE concentration percentage is the percentage of all the employer's employees who are NHCEs. Under this approach, a classification that satisfies the safe harbor is treated as nondiscriminatory without the need to establish, based on all the relevant facts and circumstances, that the classification is nondiscriminatory. The Treasury Department and the IRS propose this safe harbor to provide employers with certainty and to align the testing of eligibility classifications with established nondiscrimination concepts used in other employee benefit contexts. See, e.g., § 1.410(b)-4(c)(2) (safe harbor for nondiscriminatory classification test under section 410(b)).

As discussed in Part B.6 of this Explanation of Provisions, excluded employees are not taken into account under the eligibility rules in proposed §§ 1.128-3(b) and 1.129-2(b).

4. Owner concentration

Proposed § 1.129-2(c) would provide rules for applying the owner concentration limitation in section 129(d)(4). Under that statutory rule, not more than 25 percent of the amounts paid or incurred by the employer for dependent care assistance during the year may be provided for the class of individuals who are shareholders or owners (or their spouses or dependents) each of whom owns more than 5 percent of the stock or of the capital or profits interest in the employer on any day of the year. Proposed § 1.129-2(c) would restate this statutory requirement, which imposes a separate limitation based on ownership rather than compensation. No similar owner concentration limitation applies under section 128, and accordingly the proposed regulations under section 128 do not include a corresponding rule. However, as discussed in Part A of this Explanation of Provisions, the income exclusion under section 128 is not available to self-employed individuals. Accordingly, self-employed individuals in their capacity as such may not participate in a section 128 Trump account contribution program.

5. Average benefits

Proposed §§ 1.128-3(c) and 1.129-2(d) would provide rules for applying the average benefits test under sections 128(c) and 129(d)(8), respectively. A program satisfies this statutory test if the average benefits provided to NHCEs under all Trump account contribution programs and dependent care assistance programs of the employer, respectively, are at least 55 percent of the average benefits provided to HCEs.

Proposed §§ 1.128-3(c) and 1.129-2(d) would provide a framework for applying this test. In general, the average contributions and benefits provided to a group of HCEs or NHCEs under all Trump account contribution programs or dependent care assistance programs of the employer, respectively, for a plan year would equal the total dollar amount of such contributions and benefits provided during the plan year to employees in that group, divided by the number of employees in that group to whom such contributions and benefits in a dollar amount greater than zero are provided during the plan year, via salary reduction or otherwise. Proposed §§ 1.128-3(c) and 1.129-2(d) would further clarify that, solely for purposes of this calculation, an employee is taken into account in the denominator only if the employee is provided contributions and benefits under a Trump account contribution program or a dependent care assistance program of the employer, respectively, in an amount greater than zero during the plan year, and that these rules apply only for purposes of determining compliance with the average benefits test. Proposed §§ 1.128-3(c) and 1.129-2(d) would also reflect the statutory rule permitting a program, in the case of contributions and benefits provided through a salary reduction agreement, to disregard employees whose compensation is less than $25,000. Additionally, as discussed in Part B.6 of this Explanation of Provisions, excluded employees are not taken into account in the average benefits test.

Proposed §§ 1.128-3(c)(3) and 1.129-2(d)(3) would provide parallel timing rules for applying the average benefits test. Under proposed §§ 1.128-3(c)(3) and 1.129-2(d)(3), compliance with the average benefits test is determined as of the last day of the plan year, taking into account any individual employed on any day of the plan year who is not an excluded employee and who was provided section 128 contributions or dependent care assistance program benefits, as applicable, via salary reduction or otherwise, on any day during the plan year. The Treasury Department and the IRS are proposing these rules to provide a uniform testing date and to ensure that the test takes into account all relevant employees, rather than only employees employed or participating at a particular time during the plan year. The Treasury Department and the IRS request comments on whether any additional information would be helpful in applying the average benefits test.

6. Excluded employees

Proposed §§ 1.128-3(e) and 1.129-2(f) would provide rules identifying employees who are excluded from consideration for purposes of applying specified nondiscrimination requirements. Consistent with section 129(d)(9),[7] proposed §§ 1.128-3(e) and 1.129-2(f) would provide that, for purposes of the eligibility and average benefits tests, an employer shall exclude employees who have not attained age 21 and completed one year of service, subject to rules similar to the rules of section 410(b)(4). An employer shall also exclude employees not included in the Trump account contribution program or the dependent care assistance program who were covered by a collective bargaining agreement if there is evidence that the relevant benefits were the subject of good faith bargaining between employee representatives and the employer or employers.

The Treasury Department and the IRS are proposing these rules to reflect the statutory exclusions from nondiscrimination testing and to clarify the circumstances in which those employees are disregarded in applying the eligibility and average benefits rules. Proposed §§ 1.128-3(e) and 1.129-2(f) are generally parallel in this respect.

7. Pilot match contribution arrangement safe harbor

Employers have expressed concern that their announced intentions to match payments made to Trump accounts of dependents of employees pursuant to the section 6434 Trump accounts contribution pilot program available to account beneficiaries born in calendar years 2025 through 2028 may cause a plan to fail applicable nondiscrimination requirements. To address these concerns, proposed § 1.128-3(d) would provide a safe harbor disregarding these contributions for purposes of the contribution and benefits requirement of proposed § 1.128-3(a), and the average benefits percentage requirement of proposed § 1.128-3(c). The safe harbor does not apply for purposes of proposed § 1.128-3(b).

To be eligible for the safe harbor, an employer must make contributions under a pilot match contribution arrangement designed to provide contributions on behalf of employees with dependents who are eligible to receive section 6434 pilot program contributions to their Trump accounts. These contributions must be made available on the same terms and conditions to all employees who are not excluded employees. An arrangement will not fail to be a pilot match contribution arrangement because the employer adopts reasonable measures to establish eligibility. Thus, for example, an employer might determine eligibility based on the age of a dependent or might alternatively base eligibility on validation of receipt of the pilot program contribution into an employee's dependent's Trump account. In either case, the arrangement uses a reasonable measure to determine eligibility.

If an employer makes pilot match contributions and also makes other section 128 contributions, via salary reduction or otherwise, the other contributions must separately satisfy the contribution and benefits requirement and the average benefits percentage requirement. In determining whether these requirements are separately satisfied, the employer may, but is not required to, disregard the pilot match contributions.

8. Failure and remediation

Proposed §§ 1.128-3(c)(5) and (g) and 1.129-2(h) and (j) would provide rules addressing the effect of a failure to satisfy the nondiscrimination requirements and the circumstances in which a program may take remedial action. In general, these proposed rules would provide that, if a program would qualify as a Trump account contribution program or dependent care assistance program but for a failure to satisfy one or more of the applicable nondiscrimination requirements, the program would continue to be treated as satisfying those requirements with respect to employees who are NHCEs.

The proposed rules would also provide a remedial rule for failures of the average benefits test and, in the case of depen-

[7] Section 129(d)(9) applies for purposes of section 129(d)(3) and (8), which are incorporated by reference into section 128(c).

dent care assistance programs, the owner concentration test. Under proposed §§ 1.128-3(c)(5) and 1.129-2(j), if the program fails the average benefits test as of the last day of the plan year, the program may nonetheless be treated as satisfying that requirement if, on or before the deadline for furnishing Form W-2 for the year in which the benefits were provided, the employer includes in the gross income of affected HCEs the amount of excess benefits determined under the proposed regulations. In the case of dependent care assistance programs, proposed § 1.129-2(j)(3) would provide a similar remedial rule for excess ownership concentration.

In general, if all HCEs have benefits in excess of the amount that would satisfy the 55-percent average benefits threshold, the excess benefit amount for each HCE is determined by reference to that threshold. If not all HCEs have benefits in excess of that amount, proposed §§ 1.128-3(c)(5)(ii)(B)(*2*) and 1.129-2(j)(2)(ii) would permit the employer to allocate the excess benefit and required reduction among HCEs in any reasonable manner, including methods similar to those used under § 1.401(k)-2(b)(2)(iii).

A similar allocation of an excess ownership concentration is permitted in the case of failures to satisfy the ownership concentration test. In that case, the permitted concentration amount is subtracted from the benefit provided to participating principal shareholders or owners (defined to include their spouses and dependents) to determine the amount to be included in income. The permitted concentration amount is 25 percent of the total dependent care benefits provided by the employer to all participants during the year divided by the number of participating principal shareholders or owners.

The Treasury Department and the IRS are proposing these regulations to provide a practical correction mechanism for failures, while preserving the statutory focus on preventing HCEs from receiving the benefit of discriminatory arrangements. Proposed §§ 1.128-3(c)(5) and 1.129-2(j) are intended to allow employers to correct certain failures through income inclusion, rather than by requiring adjustment of benefits that have already been provided.

The proposed regulations regarding nondiscrimination remediation rules under sections 128 and 129 are generally parallel, but there are certain substantive differences between the two. First, because there is no corresponding ownership concentration test under section 128, no remediation rule for an ownership concentration failure is needed under section 128. In contrast, proposed § 1.129-2(j) would permit remediation for failures of either the ownership concentration test in section 129(d)(4) or the average benefits test in section 129(d)(8). Second, proposed § 1.128-3(c)(5)(ii)(A), through its cross-reference to § 1.128-2(h)(4), would require that the Trump account contribution program provide a corrective notice to advise the trustee that the contribution is not a section 128 contribution.

C. *Applicability Date*

These proposed regulations are proposed to apply to plan years beginning on or after the date final regulations are published in the **Federal Register**. Taxpayers may rely on these proposed regulations for plan years beginning before the date final regulations are published in the **Federal Register**.

IV. Special Analyses

Regulatory Planning and Review

Executive Orders 12866 and 13563 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility.

The proposed regulations have been designated by the Office of Management and Budget's (OMB's) Office of Information and Regulatory Affairs (OIRA) as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (MOA, July 4, 2025) between the Treasury Department and the OMB regarding review of tax regulations. OIRA has determined that the proposed rulemaking is a significant regulatory action under section 3(f) of Executive Order 12866 and subject to review under Executive Order 12866 and section 1(b) of the MOA. Accordingly, the proposed regulations have been reviewed by OMB. This proposed rule is not expected to be considered a regulatory action under Executive Order 14192 because it does not impose any more than de minimis regulatory costs.

Need for Regulation

The proposed regulations would clarify the rules for employer contributions to Trump accounts under section 128 of the Internal Revenue Code (Code) and the rules for nondiscrimination testing under sections 128 and 129 of the Code.

The Statute and the Proposed Regulations

Public Law 119-21, commonly referred to as the One, Big, Beautiful Bill Act (OBBBA), added new sections 530A, 128, and 6434 to the Code. Section 530A describes Trump accounts, section 128 describes certain employer contributions to Trump accounts, and section 6434 describes the Trump accounts contribution pilot program. The proposed regulations provide guidance on employer contributions to Trump accounts under section 128.

Section 530A defines a Trump account as a traditional individual retirement account (IRA) with some special rules. Most special rules that distinguish Trump accounts from other IRAs apply only during the growth period. The first day of the growth period is the day the account is established, and the final day of the growth period is December 31 of the calendar year in which the account beneficiary attains age 17. The rules for traditional IRAs generally apply after the growth period. A Trump account may be established for the benefit of a child prior to the calendar year in which the child attains age 18 if the child has been issued a social security number.

In general, distributions from Trump accounts are not permitted during the growth period. The entire balance of a Trump account may be rolled over in a direct trustee-to-trustee transfer to a new Trump account of the account beneficiary.

The entire balance of a Trump account may be rolled over in a direct trustee-to-trustee transfer to an ABLE account of the account beneficiary in the calendar year the account beneficiary attains age 17.

Investments in a Trump account must track the returns of a broad index of equities in primarily U.S. companies for which regulated futures contracts are traded, avoid the use of leverage, and avoid annual fees and expenses above 0.1 percent. Trump accounts may receive contributions from nonprofits, governments, employers, and individuals. In general, contributions to a Trump account are subject to an annual limit of $5,000, adjusted for inflation.

Governments and nonprofits may make qualified general contributions through the Treasury Department, and such contributions must be allocated in equal amounts to the Trump accounts of every account beneficiary in a qualified class. Qualified general contributions from governments and nonprofits through the Treasury Department do not count towards the $5,000 annual contribution limit.

Section 128 sets rules for certain employer contributions to Trump accounts. Employers may contribute to the Trump account of an employee or an employee's dependent. Section 128 contributions to a Trump account are excluded from the employee's income, up to an annual limit of $2,500, adjusted for inflation. Section 128 contributions count towards the $5,000 annual contribution limit.

Section 6434 describes the Trump accounts contribution pilot program. In the pilot program, the Secretary will pay $1,000 to the Trump accounts of eligible children. A U.S. citizen born in 2025, 2026, 2027, or 2028 who has been issued a social security number and for whom no request for a pilot program contribution has previously been processed is eligible for a pilot program contribution. Pilot program contributions do not count towards the $5,000 annual contribution limit.

All other contributions to a Trump account, including contributions from friends or family members, create investment in the contract and count towards the $5,000 annual contribution limit.

Section 129 describes dependent care assistance programs. Under section 129, an employee may exclude from gross income employer-provided dependent care assistance furnished under a qualifying program. To qualify, the program must satisfy nondiscrimination rules for eligibility and benefits, limit benefits for more-than-5-percent shareholders or owners to no more than 25 percent of total program benefits and provide average benefits to non-highly compensated employees equal to at least 55 percent of those provided to highly compensated employees. The exclusion is generally limited to $7,500, or $3,750 for married individuals filing separately, for taxable years beginning after December 31, 2025.

The proposed regulations are just one piece of the implementation of section 70204 of OBBBA; prior guidance addressed the election to open an initial Trump account and the election to receive a pilot contribution, and future guidance will address other Trump account issues. In addition to addressing issues specific to Trump accounts, the proposed regulations also address nondiscrimination testing in the context of both section 128 Trump account contribution programs and section 129 dependent care assistance programs.

The proposed regulations would define various terms for the purposes of section 128. The proposed regulations would adopt the common law definitions of employee and employer for section 128. An implication of these definitions of employee and employer is that a section 128 contribution cannot be made by a self-employed individual; a section 128 contribution must be made by an employer to the Trump account of an employee or an employee's dependent. The proposed regulations define dependent by cross referencing section 152. Other definitions in the proposed regulations generally adhere closely to definitions from section 128, other statutes, or prior regulations.

The proposed regulations would provide rules for Trump account contribution programs. Trump account contribution programs would be required to notify eligible employees of the terms of the program, report annually to an employee on Form W-2 or other written document the section 128 contributions made for that employee during the prior calendar year, verify that the destination of a section 128 contribution is a Trump account, identify a section 128 contribution as such to the trustee when it is made, and notify the trustee within a reasonable period (generally, within 21 calendar days) if a contribution previously identified as a section 128 contribution is later determined not to be a section 128 contribution. Trump account contribution programs would be permitted to rely on an employee's certification of the age of the account beneficiary and the employee's relationship to the account beneficiary. Trump account contribution programs would not be permitted to limit contributions to accounts held by one or more particular trustees.

The proposed regulations would provide rules for the use of section 125 cafeteria plans by Trump account contribution programs. A Trump account contribution program would be permitted to allow an employee to fund a section 128 contribution to a dependent's Trump account via salary reduction under a section 125 cafeteria plan. A cafeteria plan that includes section 128 contributions would be required to allow an employee to prospectively change or revoke elections at least monthly.

The proposed regulations would clarify the statutory limit on section 128 contributions. Section 128 contributions are generally excludable from the income of the employee and limited to $2,500 per year. The $2,500 section 128 contribution limit would apply to each employee, regardless of how many employers the employee has and regardless of how many dependents the employee has. Employer contributions in excess of $2,500 would not be excludable from the gross income of the employee.

The proposed regulations would define various terms for the purposes of section 129. In contrast to section 128, the definition of employee for section 129 would include both common law employees and self-employed individuals. For both section 128 and section 129, the proposed regulations would adopt the definition of HCE in section 414(q).

The proposed regulations would provide nondiscrimination rules for Trump account contribution programs under section 128 and dependent care assistance programs under section 129. The proposed regulations would require section 128 and section 129 benefits to be made available on terms that do not discriminate in favor of HCEs or their dependents. The proposed regulations would require eligibility classifications to be reasonable, based on objective business criteria, and nondiscriminatory under either a facts-and-circumstances test or a numerical safe harbor. The facts-and-circumstances test would include consideration of the business reason for the classification, the percentage of eligible HCEs, and the percentage of eligible non-HCEs. The numerical safe harbor would be satisfied if the percent of non-HCEs eligible is at least 90 percent as large as the percent of HCEs eligible, and the 90 percent threshold would be reduced by 3/4 of a percentage point for each whole percentage point by which the percent of an employer's employees who are non-HCEs exceeds 60 percent.

The proposed regulations would clarify that the average benefits test, which requires that average benefits of non-HCEs be at least 55 percent as large as average benefits of HCEs, is based exclusively on employees who receive more than zero benefits during the plan year. The proposed regulations would exclude employees under age 21, employees who have not completed one year of service, and certain collectively bargained employees from the eligibility and average benefits tests. The proposed regulations would provide a nondiscrimination testing safe harbor for section 128 contributions tied to section 6434 pilot program contributions, if those section 128 contributions are made available on the same terms and conditions to all non-excluded employees. The proposed regulations would generally preserve favorable treatment for non-HCEs after a nondiscrimination failure and would allow certain average benefits failures, and section 129 owner concentration failures, to be remediated no later than the general deadline for W-2 reporting through income inclusion for affected individuals.

Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the proposed regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations.

Affected Entities and Taxpayers

The proposed regulations are expected to affect 73 million children in 44 million families and 3 million employers.

Economic Effects of the Proposed Regulations

The proposed regulations generally minimize compliance burdens on employers, subject to the access requirements of taxpayers, operational requirements of Trump account trustees, and applicable law. Some employers have announced intentions to "match" the $1,000 pilot payments from the U.S. Treasury. The proposed regulations facilitate the prompt implementation of that structure by giving employers a safe harbor from nondiscrimination testing.

In the long run, the most important aspect of section 128 is likely to be the ability of employers to facilitate pre-tax contributions by their employees. The proposed regulations clarify how section 128 contributions can be made via salary reduction through a cafeteria plan. Pre-tax contributions to a Trump account are on par with pre-tax contributions to other traditional IRAs, and they are even competitive with section 529 accounts in the context of family savings for higher education expenses.

Comparisons with other savings vehicles for children are challenging in practice because they involve long time horizons and uncertainty about future income and tax rates. Nevertheless, an apples-to-apples comparison is possible with a clear question and clear assumptions. If a family saves one dollar of after-tax income now, how many after-tax dollars will the child have in 20 years? Table 1 shows the answers when the after-tax dollar is saved in a section 529 account, a Trump account through a pre-tax contribution, and a Trump account through an after-tax contribution, assuming a 10 percent annual nominal rate of return, a 27 percent present marginal tax rate (including a 22 percent federal marginal tax rate and a 5 percent state marginal tax rate), and a 17 percent future marginal tax rate (including a 12 percent federal marginal tax rate and a 5 percent state marginal tax rate).

Account	After-tax future value in 20 years generated by one present after-tax dollar	Formula
529	7.08	$\frac{1}{1-SMTR_P}(1+RETURN)^{20}$
530A (pre-tax contribution)	7.65	$\frac{1-MTR_F}{1-MTR_P}(1+RETURN)^{20}$
530A (after-tax contribution)	5.75	$(1-MTR_F)((1+RETURN)^{20}-1)+1$

Note: The present marginal tax rate (MTR_P) is assumed to be 27 percent (including 22 percent federal and 5 percent state). The future marginal tax rate (MTR_F) is assumed to be 17 percent (including 12 percent federal and 5 percent state). The present state marginal tax rate ($SMTR_P$) is assumed to be 5 percent.

These comparisons do not incorporate the "kiddie tax" in section 1(g) of the Code or how financial aid might be impacted by taking distributions while a child is in college. Pre-tax contributions to Trump accounts will not be universally better for families than contributions to section 529 accounts, but they are competitive.

By minimizing compliance burdens for employers, the proposed regulations make widespread adoption of Trump account contribution programs, including programs that permit pre-tax contributions through a cafeteria plan, more likely.

Pilot program safe harbor

The proposed regulations would clarify how to apply the nondiscrimination rules to section 128 contributions. The proposed regulations would provide a safe harbor under which section 128 contributions are disregarded for purposes of the contributions and benefits rule and average benefits test, but not for purposes of the eligibility rule, if the contributions are tied to section 6434 pilot program contributions and made available on the same terms and conditions to all non-excluded employees. An alternative would be to provide no safe harbor, such that employers would be required to do ordinary nondiscrimination testing. The same-terms safe harbor gives employers the legal certainty they need to implement a match for section 6434 pilot contributions and is narrow enough to prevent employers from targeting the benefit to HCEs. Employers will be more likely to match the pilot contribution as a result of the safe harbor, which could benefit up to 15 million children expected to be born in 2025 through 2028. With median historical returns, an additional $100 in contributions made by an employer to a newborn would result in an additional $620 dollars in the account when the child turns 18.

Many employers offer benefits to support families with children. As of March 2025, 13 percent of civilian employees had access to childcare, 46 percent had access to a dependent care flexible spending account, and 85 percent had access to personal leave, sick leave, or paid family leave. Using the same-terms safe harbor makes it more likely that employers will offer broadly available matches for section 6434 pilot contributions through a Trump account contribution program. However, section 128 contributions that are tied to section 6434 pilot contributions will be more costly to employers than section 128 contributions that are structured as a salary reduction through a cafeteria plan. Section 128 contributions structured as salary reductions shift employer costs from one purpose (salaries) to a different purpose (benefits) without increasing total costs. Section 128 contributions structured as a "match" to the pilot contribution do not shift costs from one purpose to another, they simply increase the employer's cost of providing benefits. The extent of adoption will be limited to employers who are willing to bear the incremental marginal cost of a new benefit for employees.

Eligibility classification safe harbor

The proposed regulations would clarify how to apply the eligibility component of the nondiscrimination rules for section 128 and section 129 benefits. The proposed regulations would provide a safe harbor under which benefits satisfy the eligibility test if the percentage of non-highly compensated employees eligible for the benefit is at least 90 percent as large as the percentage of highly compensated employees eligible for the benefit. The 90 percent threshold would be reduced by three-fourths of a percentage point for each whole percentage point by which the percentage of the employer's employees who are non-highly compensated employees exceeds 60 percent. Alternatives would be to provide a safe harbor with a different percentage, use a fixed threshold that does not vary with workforce composition, or provide no safe harbor. The 90 percent threshold is high enough to ensure that eligibility is broadly available to non-highly compensated employees and flexible enough to account for employers with workforces that are heavily composed of non-highly compensated employees. A safe harbor gives employers more certainty in designing section 128 and section 129 benefits and reduces the compliance burden of applying a facts-and-circumstances eligibility test. Facts-and-circumstances tests are generally more costly to comply with because they are more complicated. Evaluating a multi-pronged test is harder than checking a simple numerical threshold.

The eligibility classification safe harbor makes it more likely that employers will offer section 128 and section 129 benefits. However, the safe harbor is narrow enough, starting at a threshold of 90 percent, such that employers meeting the safe harbor would in any case have some confidence of satisfying the facts-and-circumstances test. The eligibility classification safe harbor is more of a relief from compliance burdens than a relaxation of the eligibility component of nondiscrimination testing. The relief from compliance burdens makes it more likely that employers will offer Trump account contribution programs and dependent care assistance programs and reduces the compliance costs of administering those programs.

Remediation deadline

The proposed regulations would clarify when employers may correct certain nondiscrimination failures for section 128 and section 129 benefits through income inclusion for affected individuals. The proposed regulations would provide that certain average benefits failures, and section 129 owner concentration failures, may be remediated no later than the general deadline for W-2 reporting. Alternatives would be to require remediation by the end of the plan year, allow remediation through a later amended return process, or provide no remediation deadline. The W-2 reporting deadline is late enough to give employers time to identify nondiscrimination failures after year-end and early enough to ensure that affected amounts are included in income through the regular annual wage reporting system. A clear remediation deadline gives employers certainty, preserves administrability for payroll reporting, and helps ensure that failed benefits are taxed to the affected individuals.

Correction periods in other retirement and tax contexts commonly allow time for orderly correction rather than requiring immediate action. For example, under IRS self-correction rules, many significant retirement plan operational failures may be corrected before the end of the third plan year after the year of the failure. The excise tax rules for prohibited transactions also distinguish between an initial tax of

15 percent of the amount involved and an additional 100 percent tax if the transaction is not corrected within the taxable period. Compared with these correction frameworks, a remediation deadline tied to the deadline for Form W-2 is relatively prompt. However, the remedy of including benefits in the income of affected individuals is also relatively straightforward, so the impact of the remediation deadline is likely small.

Corrective notice timing

The proposed regulations would clarify the timing and information reporting obligations for Trump account contribution programs that make section 128 contributions. The proposed regulations would require a program to identify a section 128 contribution as such to the trustee when the contribution is made and to notify the trustee within a reasonable period (within 21 calendar days is deemed a reasonable period) if a contribution previously identified as a section 128 contribution is later determined not to be a section 128 contribution. Alternatives would be to require immediate notice, provide a longer correction period, or provide no specific deadline. The 21-day deadline is long enough to give contribution programs time to identify and process errors and short enough to allow trustees to maintain accurate account records before errors become difficult to correct. A clear 21-day deadline gives trustees timely information, reduces uncertainty about the tax character of contributions, and supports consistent administration of Trump accounts.

As noted in the previous section, correction periods in other retirement and tax contexts commonly allow time for orderly correction rather than requiring immediate action. Compared with other retirement and tax correction frameworks, the 21-day corrective notice requirement is relatively prompt. However, the circumstances leading to a corrective notice are expected to be rare, so the impact of the 21-day corrective notice deadline is expected to be small.

Salary reduction election change frequency

The proposed regulations would clarify how cafeteria plan election rules apply to section 128 contributions. The proposed regulations would require a cafeteria plan that includes section 128 contributions to allow an employee to prospectively change or revoke elections at least monthly. Alternatives would be to require more frequent election changes, allow less frequent election changes, or provide no specific frequency rule. The monthly frequency is frequent enough to give employees flexibility to adjust section 128 contributions as household budgets and savings needs change and limited enough to avoid imposing excessive administrative burdens on employers and payroll systems. A clear monthly election-change rule gives employers a workable standard for plan administration and gives employees meaningful access to adjust section 128 contributions during the plan year. The impact of requiring a cafeteria plan to allow changes at least monthly is expected to be small. The marginal cost to employers of building the capacity for employees to change elections at least monthly is likely to be a one-time cost. Most cafeteria plans already have this capacity for HSA and section 401(k) contributions because the proposed timing rule is similar to the timing rules for HSA and section 401(k) contributions, and Treasury and the IRS expect most employees to rarely change their contributions within a plan year.

Statement of contributions by W-2

The proposed regulations would clarify how Trump account contribution programs must notify employees of section 128 contributions made for them during the prior calendar year. The proposed regulations would allow the annual notice requirement to be satisfied on Form W-2 or another written document. Alternatives would be to require a separate stand-alone notice, prescribe a specific Treasury or IRS form, or require reporting only on Form W-2. Allowing Form W-2 reporting is flexible enough to let employers use an existing wage reporting process and specific enough to ensure that employees receive annual information about section 128 contributions in a familiar year-end document. A Form W-2 option reduces compliance costs for employers, limits duplicative reporting, and helps employees identify section 128 contributions when preparing their tax returns. Allowing the statement of contributions requirement to be satisfied by Form W-2 is expected to minimize compliance burdens.

Summary

Based on the available models and data, the Treasury Department and the IRS estimate that the proposed regulations would minimize compliance burdens and make employers more likely to create Trump account contribution programs, including programs that allow employees to fund pre-tax contributions to Trump accounts. The Treasury Department and the IRS invite public comments and additional data on the economic effects that would result from these proposed regulations.

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking will be submitted, under approval number 1545-*NEW*, to the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, C:DC:TS:CAR:MP:T:M:S, Washington, DC 20224. Comments on the collection of information should be received by October 13, 2026. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in §§ 1.128-2, 1.128-3, 1.129-1, and 1.129-2. This information is necessary to provide guidance with respect to employer contributions to Trump accounts and the nondiscrimination rules for dependent care assistance programs. The collection of information is required to comply with the provisions of section 70204 of the OBBBA. The likely respondents are employers maintaining a Trump account contribution program or a dependent care assistance program.

The estimated number of respondents is 217,000.

The estimated average annual burden per respondent varies from 2 to 14 hours, depending on individual circumstances, with an estimated average of 8 hours.

The estimated total annual reporting burden is 1,736,000 hours.

The estimated frequency of responses is annually.

An agency may not conduct or sponsor, and a person is not required to respond to a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Regulatory Flexibility Act

The Secretary of the Treasury certifies that these proposed regulations will not have a significant economic impact on a substantial number of small entities pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6). This certification is based on the fact that these proposed regulations would not impose significant reporting requirements on small entities.

These proposed regulations would apply to employers maintaining a Trump account contribution program under section 128 or a dependent care assistance program under section 129. For purposes of section 128, these proposed regulations would include requirements related to a written plan, employee certifications, section 125 cafeteria plan elections (if applicable), notifications to employees, statements of contributions, employer-to-trustee communications, corrective notices (if applicable), and nondiscrimination requirements. It is estimated that the written plan requirement would take no more than three hours to complete, the nondiscrimination requirements would take no more than two hours to complete, and the other requirements would take no more than one hour to complete. For purposes of section 129, these proposed regulations would not impose any new requirements on small entities but rather provide clarifications to assist employers in satisfying existing requirements under the statute, including requirements for a written plan and nondiscrimination requirements. It is estimated that the written plan requirement would take no more than three hours to complete, if a written plan has not already been adopted, and the nondiscrimination requirements would take no more than two hours to complete and are largely already performed by employers with dependent care assistance programs.

The Treasury Department and the IRS also expect that Trump account contribution programs and dependent care assistance programs are primarily maintained by large employers, given that small employers are less likely to adopt these programs. Small employers that do adopt these programs may be more likely to use third-party administrators to satisfy any reporting requirements.

For these reasons, these proposed regulations are unlikely to impact a substantial number of small entities and any economic impact to small entities is expected to be insignificant. Therefore, a Regulatory Flexibility Act analysis is not required.

Notwithstanding this certification, the Treasury Department and the IRS invite comments on the impacts these proposed regulations may have on small entities.

Section 7805(f)

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million (updated annually for inflation). This proposed rule does not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

Executive Order 13132: Federalism

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. These proposed regulations do not have federalism implications and do not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

V. Comments and Public Hearing

Before these proposed amendments to the regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in the preamble under the **ADDRESSES** section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any comments submitted will be made available at *www.regulations.gov* or upon request. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn.

A public hearing is being held on October 15, 2026, beginning at 10 a.m. ET, in the Auditorium at the Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. Participants may alternatively attend the public hearing by telephone.

The public hearing will be conducted according to the procedures set out in 26 CFR 601.601(a)(2) and (3). Persons who wish to testify at the hearing must submit written or electronic comments and an outline of the topics to be discussed as well as the time to be devoted to each topic by September 25, 2026. A period of ten minutes will be allocated to each person for making comments. After the deadline for receiving outlines has passed, the IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available at *www.regulations.gov*, search IRS and REG-101355-26. Copies of the agenda will also be available by emailing a request to *publichearings@irs.gov*. Please put "REG-101355-26 Agenda Request" in the subject line of the email. Copies of the agenda will be available free of charge at the hearing. If no outlines of the topics to be discussed at the hearing are received by September 25, 2026, the public hearing will be cancelled. If the public hearing is cancelled, a notice of cancellation of the hearing will be published in the **Federal Register**.

Individuals who want to testify in person at the public hearing must send an email to *publichearings@irs.gov* to have their name added to the building access list. The subject line of the email must contain the regulation number (REG-101355-26) and the language TESTIFY In Person. For example, the subject line may say: Request to TESTIFY in Person at Hearing for REG-101355-26.

Individuals who want to testify by telephone at the public hearing must send an email to *publichearings@irs.gov* to receive the telephone number and access code for the hearing. The subject line of the email must contain the regulation number REG-101355-26 and the language TESTIFY Telephonically. For example, the subject line may say: Request to TESTIFY Telephonically at Hearing for REG-101355-26.

Individuals who want to attend the public hearing in person without testifying must also send an email to *publichearings@irs.gov* to have the individual's name added to the building access list. The subject line of the email must contain the regulation number REG-101355-26 and the language ATTEND In Person. For example, the subject line may say: Request to ATTEND Hearing In Person for REG-101355-26. Requests to attend the public hearing must be received by 5 p.m. ET on October 13, 2026.

Individuals who want to attend the public hearing by telephone without testifying must also send an email to *publichearings@irs.gov* to receive the telephone number and access code for the hearing. The subject line of the email must contain the regulation number REG-101355-26 and the language ATTEND Telephonically. For example, the subject line may say: Request to ATTEND Hearing Telephonically for REG-101355-26. Requests to attend the public hearing must be received by 5 p.m. ET on October 13, 2026.

Any questions regarding speaking at or attending the public hearing may also be emailed to *publichearings@irs.gov*. Hearings will be made accessible to people with disabilities. To request special assistance during a hearing please contact the Publications and Regulations Section of the Office of Associate Chief Counsel (Procedure and Administration) by sending an email to *publichearings@irs.gov* (preferred) or by telephone at (202) 317-6901 (not a toll-free number) by October 9, 2026.

VI. Statement of Availability of IRS Documents

Guidance cited in this preamble is published in the Internal Revenue Bulletin and is available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *https://www.irs.gov*.

VII. Drafting Information

The principal author of these proposed regulations is the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). Personnel from the Treasury Department and the IRS also participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Par. 2. Sections 1.128-1 through 1.129-2 are added to read as follows:

* * * * *

Sec.
1.128-1 Trump account contribution program; definitions.
1.128-2 Trump account contribution program; in general.
1.128-3 Nondiscrimination requirements.
1.129-1 Dependent care assistance programs.
1.129-2 Nondiscrimination requirements.

* * * * *

§ 1.128-1 Trump account contribution program; definitions.

Definitions. For purposes of section 128 and this section and §§ 1.128-2 and 1.128-3—

(a) *Dependent*. The term *dependent* means an individual who, for the calendar year in which the contribution is made, the employee anticipates will be a dependent of the employee under section 152. In the case of a married couple filing a joint return, an individual is treated as the dependent of both individuals filing the joint return.

(b) *Employee*—(1) *In general*. The term *employee* means an individual who is an employee under the common-law standard described in § 31.3401(c)-1 of this chapter.

(2) *Self-employed individuals not treated as employees*. The term *employee* does not include a self-employed individual within the meaning of section 401(c)(1). A self-employed individual may maintain a Trump account contribution program covering the employees of the self-employed individual's trade or business, but the self-employed individual may not participate in the program.

(c) *Employer*. The term *employer* means the person that is the employer of an employee under the common-law standard described in § 31.3401(c)-1 of this chapter. If the employer is a member of a group of employers that are treated as a single employer under the rules of section 414(b), (c), (m), or (o), then all employers in that group will be treated as a single employer for purposes of section 128. The rules of section 414 shall apply with respect to a Trump account contribution program in the same manner as they would with respect to a dependent care assistance program under section 129.

(d) *Growth period*. The term *growth period* means, with respect to an account beneficiary, the period that begins when the initial Trump account is established and ends on December 31 of the calendar year in which the account beneficiary attains age 17. For example, a child born on October 1, 2025, would attain age 17 on October 1, 2042, and the last day of the growth period with respect to the child would be December 31, 2042.

(e) *Highly compensated employee*. The term *highly compensated employee* or *HCE* has the meaning set forth in section 414(q).

(f) *Non-highly compensated employee*. The term *non-highly compensated employee* or *NHCE* means an employee who is not a highly compensated employee.

(g) *Plan year*. The term *plan year* means the 12-month period on the basis of which the Trump account contribution program is administered or, if shorter, the period for which the program is maintained.

(h) *Section 128 contribution*. The term *section 128 contribution* means a contribution made by an employer to a Trump account under a Trump account contribution program.

(i) *Trump account*. The term *Trump account* has the meaning set forth in section 530A(b)(1).

(j) *Trump account contribution program*. The term *Trump account contribution program* means a separate written plan of an employer for the exclusive benefit of its employees to provide contributions to the Trump accounts of the employees or their dependents that meets the requirements of § 1.128-2(b) through (h).

(k) *Applicability date*. This section applies to plan years beginning on or after the date of publication of the final rule in the **Federal Register**.

§ 1.128-2 Trump account contribution program; in general.

(a) *Exclusion from gross income for contributions*. Gross income of an employee does not include an amount paid by the employer as a contribution, including by salary reduction to the extent permitted under paragraph (d)(7) of this section, to the Trump account of the employee or of any dependent of the employee pursuant to a Trump account contribution program.

(b) *Requirement of separate written plan*.

(1) A Trump account contribution program must be set forth in a separate written plan that includes the items specified in paragraph (b)(2) of this section.

(2) The written plan must specify—

(i) The classes of employees eligible to participate;

(ii) The rules governing employer contributions, including the amount of contributions and whether contributions may be made via a section 125 cafeteria plan salary reduction arrangement;

(iii) The procedures under which an employee must designate the Trump account of the employee or of a dependent of the employee to receive contributions;

(iv) The certification, notice, and reporting procedures required under paragraphs (d), (f), and (g) of this section;

(v) The plan year; and

(vi) The procedures for correcting administrative failures and for furnishing notices to employees and trustees when amounts previously designated as section 128 contributions are subsequently determined not to be excludable from an employee's gross income under section 128(a) (for example, due to the nondiscrimination requirements of paragraph (e) of this section).

(c) *Operational compliance.* The employer must follow the terms of the Trump account contribution program's written plan.

(d) *Permitted contributions*—(1) *Permitted recipients.* A Trump account contribution program may make contributions only to a Trump account whose account beneficiary—

(i) Is in his or her growth period; and

(ii) Is an employee or an employee's dependent.

(2) *Permitted amounts.* The aggregate amount contributed with respect to any employee under a Trump account contribution program may not exceed the annual limit specified in paragraph (d)(5) of this section.

(3) *Treatment of impermissible amounts.* Amounts contributed by an employer that are not permitted under paragraph (d)(1) or (d)(2) of this section are not made pursuant to a Trump account contribution program (and thus are not section 128 contributions and are not excludable from income under paragraph (a) of this section).

(4) *Certification and employer reliance*—(i) *In general*. Except as provided in paragraph (d)(4)(iii) of this section, an employer may rely on an employee certification meeting the requirements of paragraph (d)(4)(ii) of this section for purposes of determining whether a contribution satisfies the requirements of paragraph (d)(1) of this section, unless the employer has actual knowledge that the certification is incorrect.

(ii) *Content of employee certification*. An employee certification relied on under paragraph (d)(4)(i) of this section must be made in writing, in paper or electronic form, and must include the following representations:

(A) The beneficiary of the account designated for the employer contribution is the employee or anticipated to be the dependent of the employee for the employee's taxable year in which the contribution is to be made;

(B) Such account beneficiary's date of birth; and

(C) No facts known to the employee would make such account beneficiary ineligible to receive a contribution to his or her Trump account for that calendar year.

(iii) *No reliance on an employee certification that a Trump account is valid*. An employer may not rely solely on an employee certification to establish that the recipient account is a valid Trump account. The employer must use a method reasonably designed to verify, through information provided by the trustee, payroll processor, or other service provider, that the contribution is made to a valid Trump account.

(5) *Annual limits*—(i) *In general*. With respect to an employee, total contributions under a Trump account contribution program for a calendar year may not exceed the lesser of—

(A) The amount specified in section 128(b), as adjusted for inflation under section 128(b)(2); or

(B) The amount specified under the terms of the Trump account contribution program's written plan.

(ii) *Limit by employee*. The annual limit applies with respect to the employee as an individual, taking into account section 128 contributions made with respect to the employee by all employers for the employee's taxable year. The excess of any section 128 contributions received by an individual over the amount specified in section 128(b), as adjusted for inflation under section 128(b)(2) for the taxable year, (for example, due to contributions being received from Trump account contribution programs of two employers of an employee), may not be excluded from the individual's gross income under section 128(a). Thus, an individual's section 128 contributions in excess of the section 128(b) limit must be included in gross income for the employee's taxable year. See paragraph (d)(5)(iii) of this section for the effect of such contributions in excess of the limit under section 128(b) on the Trump account contribution program.

(iii) *Effect on plan.* Notwithstanding the provisions of paragraph (d)(5)(ii) of this section, an arrangement does not fail to be a Trump account contribution program by reason of an individual being in receipt of excess contributions for the taxable year, provided that the plan prohibits contributions under that plan with respect to an employee in excess of the amount specified in paragraph (d)(5)(i) of this section.

(iv) *Allocation*. A program may permit the contribution to be allocated (either by the terms of the program or by election by the employee) among the Trump account of the employee and the Trump account of one or more dependents of the employee, provided that the aggregate amount an employer contributes with respect to an employee for the calendar year does not exceed the limit specified in this paragraph (d)(5).

(v) *Section 530A(c)(2) limit*. The employer does not have any obligation with respect to compliance with the section 530A(c)(2) limit.

(vi) *Examples.* The rules of this paragraph (d)(5) are illustrated by the following examples. The examples assume that the Trump account contribution program written plan allows for contributions up to $2,500, via salary reduction or otherwise; that there are no nondiscrimination failures; that there are no other contributions to the Trump account(s) for the year; and that the Trump account contribution program has a calendar year plan year.

(A) *Example 1*. For 2027, Employee has two dependents and works for an employer that offers a Trump account contribution program under which the employer provides a section 128 contribution in the amount of $2,500 with respect to each employee. The program allows Employee to allocate the section 128 contribution among the Trump accounts of the two dependents, but the total amount allocated by Employee may not exceed $2,500 for 2027. The program complies with the annual limit requirement of this paragraph (d)(5). The conclusion would not change if the section 128 contributions were made via salary reduction.

(B) *Example 2*. For 2027, Employee and Employee's spouse, who are married and file jointly, have one dependent. The employers of Employee and Employee's spouse each offer Trump account contribution programs under which each employer provides a section 128 contribution in the amount of $2,500 with respect to each employee. Employee and Employee's spouse each allocate the $2,500 section 128 contribution to the Trump account of their dependent through their respective Trump account contribution programs. The programs comply with the annual limit requirement of this paragraph (d)(5). The conclusion would not change if the section 128 contributions were made via salary reduction.

(C) *Example 3*. The facts are the same as in paragraph (d)(5)(vi)(B) of this section (*Example 2*), except Employee and Employee's spouse both work for the same employer. Employee and Employee's spouse each allocate the $2,500 section 128 contribution to the Trump account of their dependent through the employer's Trump account contribution program. The program complies with the annual limit requirement of this paragraph (d)(5). The conclusion would not change if the section 128 contributions were made via salary reduction.

(D) *Example 4*. For 2027, Individual has one dependent. Individual is employed by two unrelated employers, each of which offers a Trump account contribution program under which the employer provides a section 128 contribution in the amount of $2,500 with respect to each employee. Each plan prohibits contributions under that plan with respect to an employee in excess of the amount specified in section 128(b), as adjusted for inflation under section 128(b)(2). Individual allocates the $2,500 section 128 contribution under each program with respect to a Trump account for Individual's dependent. The programs comply with the annual limit requirement of this paragraph (d)(5). Neither employer is required to provide a corrective notice described in paragraph (h)(4) of this section solely because of the other employer's contribution. However, Individual must include the excess contribution of $2,500 in Individual's gross income on Individual's Federal income tax return for that taxable year. The conclusion would not change if the section 128 contributions were made via salary reduction.

(E) *Example 5*. For 2027, Employee has one dependent and works for Employer, which offers a Trump account contribution program under which Employer provides a section 128 contribution in the amount of $2,500 with respect to each employee. Employee allocates the $2,500 section 128 contribution to the Trump account of Employee's dependent through Employer's Trump account contribution program. In addition to the section 128 contribution made under the Trump account contribution program, Employer contributes an additional $1,000 to the Trump account that is not a section 128 contribution made under the Trump account contribution program to Employee's dependent's Trump account. No other exclusion from gross income or wages applies to the $1,000 contribution. In accordance with the requirements of paragraph (h)(1) of this section, Employer identifies the $2,500 to the trustee as a section 128 contribution and does not identify the $1,000 as a section 128 contribution. On Employee's Form W-2, Employer reports the $2,500 to Employee as a section 128 contribution, and the $1,000 to Employee as gross income and wages. The program complies with the annual limit requirement of this paragraph (d)(5).

(6) *Selection of trustee*. An arrangement is not a Trump account contribution program if an employer limits contributions to Trump accounts held by a particular trustee or trustees.

(7) *Section 125 salary reduction arrangements*—(i) *In general*. A Trump account contribution program may be offered via salary reduction under a section 125 cafeteria plan but only if the contribution is made to a Trump account of

the dependent of an employee. A contribution to a Trump account of an employee may not be offered via salary reduction under a section 125 cafeteria plan.

(ii) *Elections*. A section 125 cafeteria plan providing for section 128 contributions through salary reduction may permit employees to make a prospective salary reduction election or change or revoke a salary reduction election for section 128 contributions (for example, to increase or decrease a salary reduction election) at any time during the plan year, provided that the election is effective only as to salary that is not yet currently available. The section 125 cafeteria plan must specifically describe the Trump account contribution benefit and permit participants to prospectively change or revoke elections at least monthly, before salary becomes currently available.

(e) *No discrimination in favor of HCEs*. A Trump account contribution program must satisfy the nondiscrimination requirements of § 1.128-3(a) through (c). An arrangement that fails to satisfy such requirements will not be considered a Trump account contribution program with respect to HCEs participating in the program, but will not affect the program's status as a Trump account contribution program with respect to the NHCE participants.

(f) *Notification to eligible employees*. Reasonable notification of the availability and terms of the Trump account contribution program must be provided to all eligible employees.

(g) *Statement of contributions*. A written statement showing the amount of section 128 contributions that were made for an employee during the previous calendar year under the employer's Trump account contribution program must be furnished to that employee. This requirement is satisfied by including the amount of Trump account contributions on the employee's Form W-2, *Wage and Tax Statement*, in the manner specified in the form's instructions for reporting of section 128 contributions.

(h) *Employer communications*—(1) *Affirmative statement*. With respect to an amount contributed under a Trump account contribution program, the employer must, at the time the amount is transmitted to the trustee, affirmatively identify the amount as a section 128 contribution in writing to the trustee.

(2) *Procedures*. The employer must adopt procedures to ensure that section 128 contributions are properly identified and to notify the trustee when a contribution is a section 128 contribution and when a contribution previously identified as a section 128 contribution is not a section 128 contribution.

(3) *Reliance by the trustee*. The trustee of a Trump account receiving a contribution may rely on the identification of a contribution as a section 128 contribution for purposes of section 530A until such time that the trustee receives a corrective notice pursuant to paragraph (h)(4) of this section or has contrary knowledge.

(4) *Corrective notice*—(i) *In general*. If an amount previously identified under paragraph (h)(1) of this section as a section 128 contribution is subsequently determined not to be a section 128 contribution, in whole or in part, the employer must provide notice in writing to the trustee identifying the affected account, the calendar year in which the contribution was made, and the amount determined not to be a section 128 contribution.

(ii) *Timing*. The notice described in paragraph (h)(4)(i) of this section must be furnished within a reasonable period of time following the date the employer determines that an amount is not a section 128 contribution. For purposes of this section, 21 calendar days following the date the employer makes this determination is deemed to be a reasonable period of time.

(i) *Applicability date*. This section applies to plan years beginning on or after the date of publication of the final rule in the **Federal Register**.

§ 1.128-3 Nondiscrimination requirements.

(a) *Contributions and benefits*. The contributions or benefits provided under the Trump account contribution program must not discriminate in favor of HCEs or their dependents. A Trump account contribution program that provides benefits on the same terms for all eligible employees satisfies this requirement. For example, a term that allows all NHCEs to reduce salary in the same amount as HCEs does not discriminate as to contributions or benefits.

(b) *Eligibility*—(1) *In general*. The program must benefit employees who qualify under an eligibility classification established by the employer that is reasonably based on objective business criteria in satisfaction of paragraph (b)(2) of this section and not found by the Secretary to be discriminatory in favor of HCEs or their dependents in satisfaction of paragraph (b)(3) of this section. For these purposes, an employee is eligible under the program only if the employee had a meaningful opportunity to receive benefits, via salary reduction or otherwise, regardless of whether any benefits were actually received.

(2) *Reasonable eligibility classification established by the employer*. An eligibility classification must be, based on all facts and circumstances, reasonable and established under objective business criteria that identify the category or categories of employees who are eligible under the plan. Reasonable classifications generally include specified job categories, nature of compensation (that is, salaried or hourly), geographic location, and similar bona fide business criteria. An enumeration of employees by name or other specific criteria having substantially the same effect as an enumeration by name is not considered a reasonable classification.

(3) *Nondiscriminatory classification*—(i) *In general.* An eligibility classification must be found by the Secretary not to be discriminatory in favor of HCEs or their dependents. A classification is nondiscriminatory for a plan year if and only if the group of employees included in the classification eligible under the plan satisfies the requirements of either paragraph (b)(3)(ii) or (iii) of this section for the plan year.

(ii) *Facts and circumstances.* A plan satisfies the requirements of this paragraph (b)(3)(ii) if and only if, based on all the relevant facts and circumstances, the Secretary finds that the classification is nondiscriminatory. No one particular fact is determinative. Included among the facts and circumstances relevant in determining whether a classification is nondiscriminatory are the following—

(A) The underlying business reason for the classification. The greater the business reason for the classification, the more likely the classification is to be nondiscriminatory.

(B) The percentage of the employer's employees eligible under the plan. The higher the percentage, the more likely the classification is to be nondiscriminatory.

(C) Whether the number of employees eligible under the plan in each salary range is representative of the number of employees in each salary range of the employer's workforce. In general, the more representative the percentages of employees eligible under the plan in each salary range, the more likely the classification is to be nondiscriminatory.

(D) The difference between the plan's ratio percentage (within the meaning of paragraph (b)(3)(iii)(A) of this section) and the employer's safe harbor percentage (within the meaning of paragraph (b)(3)(iii)(B) of this section). The smaller the difference, the more likely the classification is to be nondiscriminatory.

(iii) *Safe harbor.* A plan satisfies the requirements of this paragraph (b)(3)(iii) for a plan year if and only if the plan's ratio percentage (as defined in paragraph (b)(3)(iii)(A) of this section) is greater than or equal to the employer's safe harbor percentage (as defined in paragraph (b)(3)(iii)(B) of this section).

(A) *Ratio percentage*. For purposes of this paragraph (b)(3)(iii), with respect to a plan for a plan year, the plan's *ratio percentage* means the ratio expressed as a percentage (rounded to the nearest hundredth of a percentage point) determined by dividing the eligibility percentage of NHCEs by the eligibility percentage of HCEs, as such eligibility percentages are defined in paragraph (b)(3)(iii)(C) of this section.

(B) *Safe harbor percentage*. The safe harbor percentage of an employer is 90 percent, reduced by 3/4 of a percentage point for each whole percentage point by which the NHCE concentration percentage exceeds 60 percent.

(C) *Eligibility percentage.* The *eligibility percentage of NHCEs* is determined by dividing the number of NHCEs who are eligible under the plan by the total number of NHCEs of the employer. The *eligibility percentage of HCEs* is determined by dividing the number of HCEs who are eligible under the plan by the total number of HCEs of the employer. In determining these eligibility percentages, employees described in paragraph (e) of this section are excluded.

(D) *NHCE concentration percentage*. The *NHCE concentration percentage* of an employer is the percentage of all the employees of the employer who are NHCEs.

(c) *Average benefits test*—(1) *In general*. A plan satisfies the requirements of this paragraph (c)(1) if the average benefits provided to employees who are NHCEs under all Trump account contribution programs of the employer is at least 55 percent of the average benefits provided to HCEs under all Trump account contribution programs of the employer.

(2) *Average benefits provided*—(i) *General rule*. For purposes of paragraph (c)(1) of this section, the average benefits provided to a group of HCEs or NHCEs for a plan year equals the total dollar amount of contributions provided under all Trump account contribution programs of the employer during the plan year to employees in that group, divided by the number of employees in that group to whom any such contributions are provided during the plan year, via salary reduction or otherwise.

(ii) *Employees taken into account*. For purposes of applying the calculation in paragraph (c)(2)(i) of this section, any individual employed by the employer on any day of the plan year is taken into account in the denominator if:

(A) The employer makes a section 128 contribution to a Trump account as to which the employee or the employee's dependent is the beneficiary during the plan year, via salary reduction or otherwise; and

(B) The employee is not described in paragraph (e) of this section.

(3) *Time to perform nondiscrimination test*. The requirements of this paragraph (c) must be satisfied as of the last day of the plan year.

(4) *Salary reduction agreements*. For purposes of this paragraph (c), in the case of any benefits provided through a salary reduction agreement, a plan may disregard any employee whose compensation is less than $25,000. For purposes of this paragraph (c)(4), the term "compensation" has the meaning given such term by section 414(q)(4).

(5) *Correction of nondiscrimination failures*—(i) *In general.* If a plan fails the requirements of the average benefits test of this paragraph (c) as of the last day of the plan year, the plan may nonetheless be treated as satisfying the requirements with respect to HCEs and their dependents if the plan takes remedial action as described in paragraph (c)(5)(ii) of this section.

(ii) *Remedial measures*—(A) *Correction*. If a Trump account contribution program fails to satisfy the requirements of this paragraph (c) as of the last day of the plan year, the plan may be treated as satisfying those requirements by including in income any excess benefit amounts received by HCEs. For this purpose, an excess benefit amount is included in income if the amount is treated by the employer as gross income and, to the extent applicable, wages within the meaning of sections 3401, 3121, and 3306, and compensation within the meaning of section 3231, and reported as such with respect to the year being tested by the deadline prescribed in § 31.6051-1(d)(1)(i) of this chapter for furnishing statements on Form W-2, *Wage and Tax Statement*, for the year in which the excess benefits were received. In addition, because the excess benefit amounts are not provided under a Trump account contribution program, the plan must provide a corrective notice as provided in § 1.128-2(h)(4).

(B) *Allocation of excess benefits*. (*1*) If all HCEs have section 128 contributions in excess of the quotient of the amount of the average section 128 contribution for all NHCEs divided by 0.55, the amount of excess benefits to be included in income of each HCE is the excess of the amount of that HCE's section 128 contribution over that quotient.

(*2*) If not all HCEs have section 128 contributions in excess of the quotient of the amount of the average section 128 contribution for all NHCEs divided by 0.55, the plan may allocate the reduction of section 128 contributions among HCEs in any reasonable manner, including methods for apportioning distributions of excess amounts similar to those used in § 1.401(k)-2(b)(2)(iii).

(d) *Safe harbor for contributions made with respect to pilot program amounts*—(1) *In general.* Contributions under a pilot match contribution arrangement described in paragraph (d)(2) of this section are disregarded for the purposes of paragraphs (a) and (c) of this section.

(2) *Pilot match contribution arrangements.* A pilot match contribution arrangement must—

(i) Be designed to provide contributions to Trump accounts because the account beneficiary is:

(A) A dependent of an employee; and

(B) An eligible child within the meaning of section 6434(c); and

(ii) Make contributions under the arrangement available on the same terms and conditions to all employees not described in paragraph (e) of this section.

(3) *Establishment of eligibility.* An arrangement will not fail to be a pilot match contribution arrangement because the arrangement relies on reasonable measures to establish that an employee's dependent is an eligible child within the meaning of section 6434(c). For this purpose, employee certification of a dependent's date of birth is a reasonable measure to ensure eligibility.

(4) *Additional section 128 contributions.* If an employer makes contributions under a pilot match contribution arrangement described in paragraph (d)(2) of this section and also makes section 128 contributions that are not under such an arrangement, via salary reduction or otherwise, such contributions that are not pilot match contributions must separately satisfy paragraphs (a) and (c) of this section. In determining whether paragraphs (a) and (c) of this section are so separately satisfied, the pilot match contributions may be disregarded.

(e) *Excluded employees*. For purposes of paragraphs (b) and (c) of this section, there shall be excluded from consideration—

(1) Subject to rules similar to the rules of section 410(b)(4), employees who have not attained the age of 21 and completed one year of service (as defined in section 410(a)(3)); and

(2) Employees not included in a Trump account contribution program who are included in a unit of employees covered by an agreement that the Secretary finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that the Trump account contribution program was the subject of good faith bargaining between such employee representatives and such employer or employers.

(f) *Contributions taken into account*. For purposes of paragraphs (a), (b), and (c) of this section, an employer's contributions to the Trump account of an employee or an employee's dependent outside any Trump account contribution program (such as taxable contributions in excess of the § 1.128-2(d)(5) annual limit) are not taken into account.

(g) *Effect of failure*. Except as otherwise provided in paragraph (c)(5) of this section, if a plan would qualify as a Trump account contribution program but for a failure to satisfy one or more of the requirements of this section, then the plan is not a Trump account contribution program with respect to HCEs. Notwithstanding such failure, the plan is treated as a Trump account contribution program with respect to employees who are NHCEs.

(h) *Examples*. The following examples illustrate the rules in this section.

(1) *Example 1.* For 2026, an employer has 15 HCEs and 15 NHCEs. The employer maintains a Trump account contribution program funded solely via salary reduction elections made by employees under the employer's section 125 cafeteria plan. All 30 employees are eligible to make salary reduction elections under the plan on the same terms. Eleven of the HCEs elect benefits under the plan of $2,500 each, and four of the NHCEs elect benefits under the plan of $2,500 each. The remaining employees elect no benefits under the plan. The average benefits provided to the HCEs is $2,500 ($27,500/11) and the average benefits provided to the NHCEs is also $2,500 ($10,000/4). Accordingly, the average benefits provided to the NHCEs is 100 percent of the average benefits provided to the HCEs, and the required threshold of 55 percent under paragraph (c)(1) of this section is satisfied.

(2) *Example 2.* For 2026, an employer has 15 HCEs and 15 NHCEs. The employer maintains a Trump account contribution program funded solely via salary reduction elections made by employees under the employer's section 125 cafeteria plan. All 30 employees are eligible to make salary reduction elections under the plan on the same terms. Eleven of the HCEs elect benefits under the plan of $2,500 each; one of the NHCEs elects benefits of $2,500; three of the NHCEs elect benefits of $1,500; one of the NHCEs elects benefits of $1,000; and two of the NHCEs elect benefits of $500, for a collective $9,000 in benefits provided to seven NHCEs, and an average benefits provided to NHCEs of $1,285.71 ($9,000/7). The average benefits provided to the HCEs is $2,500 ($27,500/11). Accordingly, the average benefits provided to the NHCEs is 51.4 percent of the average benefits provided to the HCEs ($1,285.71/$2,500), and the required threshold of 55 percent under paragraph (c)(1) of this section is not satisfied.

(3) *Example 3.* The facts are the same as in paragraph (h)(2) of this section (*Example 2*) except that the following four NHCEs are excluded employees within the meaning of paragraph (e) of this section: two of the NHCEs who elected benefits under the plan of $1,500; and the two NHCEs who elected benefits of $500. With the exclusion of these employees, a collective $5,000 in benefits are provided to three NHCEs, and the average benefits provided to NHCEs is $1,666.67 ($5,000/3). Accordingly, the average benefits provided to the NHCEs is 66.7 percent of the average benefits provided to the HCEs ($1,666.67/$2,500), and the required threshold of 55 percent under paragraph (c)(1) of this section is satisfied.

(4) *Example 4.* The facts are the same as in paragraph (h)(2) of this section (*Example 2*) except that on or before the furnishing deadline for the Form W-2 for the year in which the benefits were provided, the employer treats $500 of the benefits elected by each of the HCEs as gross income and wages for the year in which the benefits were provided, reducing the benefits provided to the HCEs to a collective $22,000 in benefits provided to 11 HCEs, reducing the average benefit to HCEs to $2,000 ($22,000/11). Accordingly, the average benefits provided to the NHCEs is 64.29 percent of the average benefits provided to the HCEs ($1,285.71/$2,000), and the required threshold of 55 percent under paragraph (c)(1) of this section is satisfied.

(5) *Example 5.* The facts are the same as in paragraph (h)(3) of this section (*Example 3*) except the employer also makes a contribution of $1,000 that is not excludable from income under section 128 (a non-section 128 contribution) to each of the employees who elected benefits under the plan. The taxable employer contributions are not considered when calculating the average benefits. Accordingly, the conclusion is the same as in paragraph (h)(3) of this section (*Example 3*).

(6) *Example 6.* The facts are the same as in paragraph (h)(1) of this section (*Example 1*) except that the 11 NHCEs to whom benefits are not provided are not eligible to elect benefits under the terms of the plan. The 11 excluded NHCEs are not excluded employees within the meaning of paragraph (e) of this section. The plan has discriminated in favor of HCEs as to eligibility and thus does not satisfy the requirements of paragraph (b) of this section. Thus, the plan is not a Trump account contribution program with respect to HCEs and the benefits provided to HCEs are included in their income and wages within the meaning of sections 3401, 3121 (or compensation within the meaning of section 3231), and 3306. Because the benefits are not provided under a Trump account contribution program, the plan must provide a corrective notice as provided in § 1.128-2(h)(4).

(i) *Applicability date*. This section applies to plan years beginning on or after the date of publication of the final rule in the **Federal Register**.

§ 1.129-1 Dependent care assistance programs.

(a) *Definitions*. For purposes of section 129, this section and § 1.129-2—

(1) *Dependent care assistance*. The term *dependent care assistance* has the meaning set forth in section 129(e)(1).

(2) *Dependent care assistance program*. The term *dependent care assistance program* means a separate written plan of an employer for the exclusive benefit of its employees to provide such employees with dependent care assistance that satisfies the requirements of section 129(d) and this section.

(3) *Dependent care assistance provided to an employee*. The term d*ependent care assistance provided to an employee* means amounts paid or incurred by the employer to provide dependent care assistance to the employee that are excludable under section 129, including amounts provided through a salary reduction agreement under a section 125 cafeteria plan.

(4) *Employee*. The term *employee* means an individual who is an employee under the common-law standard described in § 31.3401(c)-1 of this chapter, and a self-employed individual within the meaning of section 401(c)(1).

(5) *Employer*. The term *employer* means the person that is the employer of an employee under the common-law standard described in § 31.3401(c)-1 of this chapter. All persons treated as a single employer under section 414(b), (c), (m), or (o) are treated as a single employer for purposes of section 129.

(6) *Highly compensated employee or HCE*. The term *highly compensated employee* has the meaning set forth in section 414(q).

(7) *Non-highly compensated employee or NHCE*. The term *non-highly compensated employee* means an employee who is not a highly compensated employee.

(8) *Principal shareholder or owner*. The term *principal shareholder or owner* means an individual, or such individual's spouse or dependent, who (on any day of the taxable year) owns more than 5 percent of the stock or of the capital or profits interest in the employer.

(9) *Plan year*. The term *plan year* means the 12-month period on the basis of which the dependent care assistance program is administered (or, if shorter, the period for which the program is maintained).

(b) *Applicability date.* This section applies to plan years beginning on or after the date of publication of the final rule in the **Federal Register**.

§ 1.129-2 Nondiscrimination requirements.

(a) *Contributions and benefits*. The contributions or benefits provided under a plan that provides dependent care assistance must not discriminate in favor of HCEs or their dependents. A plan that provides benefits on the same terms for all eligible employees satisfies this requirement. For example, a term that allows all NHCEs to reduce salary in the same amount as HCEs does not discriminate as to contributions or benefits.

(b) *Eligibility*—(1) *In general.* The dependent care assistance program must benefit employees who qualify under an eligibility classification established by the employer that is reasonably based on objective business criteria in satisfaction of paragraph (b)(2) of this section and not found by the Secretary to be discriminatory in favor of HCEs or their dependents in satisfaction of paragraph (b)(3) of this section. For these purposes, an employee is eligible under the dependent care assistance program only if the employee had a meaningful opportunity to receive benefits, via salary reduction or otherwise, regardless of whether any benefits were actually received.

(2) *Reasonable eligibility classification established by the employer*. An eligibility classification must be, based on all facts and circumstances, reasonable and established under objective business criteria that identify the category or categories of employees who are eligible under the plan. Reasonable classifications generally include specified job categories, nature of compensation (that is, salaried or hourly), geographic location, and similar bona fide business criteria. An enumeration of employees by name or other specific criteria having substantially the same effect as an enumeration by name is not considered a reasonable classification.

(3) *Nondiscriminatory classification*—(i) *In general.* An eligibility classification must be found by the Secretary not to be discriminatory in favor of HCEs or their dependents. A classification is nondiscriminatory for a plan year if and only if the group of employees included in the classification eligible under the plan satisfies the requirements of either paragraph (b)(3)(ii) or (iii) of this section for the plan year.

(ii) *Facts and circumstances.* A plan satisfies the requirements of this paragraph (b)(3)(ii) if and only if, based on all the relevant facts and circumstances, the Secretary finds that the classification is nondiscriminatory. No one particular fact is determinative. Included among the facts and circumstances relevant in determining whether a classification is nondiscriminatory are the following—

(A) The underlying business reason for the classification. The greater the business reason for the classification, the more likely the classification is to be nondiscriminatory.

(B) The percentage of the employer's employees eligible under the plan. The higher the percentage, the more likely the classification is to be nondiscriminatory.

(C) Whether the number of employees eligible under the plan in each salary range is representative of the number of employees in each salary range of the employer's workforce. In general, the more representative the percentages of employees eligible under the plan in each salary range, the more likely the classification is to be nondiscriminatory.

(D) The difference between the plan's ratio percentage (within the meaning of paragraph (b)(3)(iii)(A) of this section) and the employer's safe harbor percentage (within the meaning of paragraph (b)(3)(iii)(B) of this section). The smaller the difference, the more likely the classification is to be nondiscriminatory.

(iii) *Safe harbor.* A plan satisfies the requirements of this paragraph (b)(3)(iii) for a plan year if and only if the plan's ratio percentage (as defined in paragraph (b)(3)(iii)(A) of this section) is greater than or equal to the employer's safe harbor percentage (as defined in paragraph (b)(3)(iii)(B) of this section).

(A) *Ratio percentage*. For purposes of this paragraph (b)(3)(iii), with respect to a plan for a plan year, the plan's *ratio percentage* means the ratio expressed as a percentage (rounded to the nearest hundredth of a percentage point) determined by dividing the eligibility percentage of NHCEs by the eligibility percentage of HCEs, as such eligibility percentages are defined in paragraph (b)(3)(iii)(C) of this section.

(B) *Safe harbor percentage*. The safe harbor percentage of an employer is 90 percent, reduced by 3/4 of a percentage point for each whole percentage point by which the NHCE concentration percentage exceeds 60 percent.

(C) *Eligibility percentage.* The *eligibility percentage of NHCEs* is determined by dividing the number of NHCEs who are eligible under the plan by the total number of NHCEs of the employer. The *eligibility percentage of HCEs* is determined by dividing the number of HCEs who are eligible under the plan by the total number of HCEs of the employer. In determining these eligibility percentages, employees described in paragraph (f) of this section are excluded.

(D) *NHCE concentration percentage*. The *NHCE concentration percentage* of an employer is the percentage of all the employees of the employer who are NHCEs.

(c) *Principal shareholders or owners*. Not more than 25 percent of the amounts paid or incurred by the employer for dependent care assistance during the year may be provided for the class of individuals who are principal shareholders or owners.

(d) *Average benefits test*—(1) *In general*. A plan satisfies the requirements of this paragraph (d) if the average benefits provided to employees who are NHCEs under all dependent care assistance programs of the employer is at least 55 percent of the average benefits provided to HCEs under all dependent care assistance programs of the employer.

(2) *Average benefits provided*—(i) *General rule*. For purposes of paragraph (d)(1) of this section, the "average benefits provided" to a group of HCEs or NHCEs for a plan year equals the total dollar amount of dependent care assistance provided under all dependent care assistance programs of the employer during the plan year to employees in that group, divided by the number of employees in that group to whom any dependent care assistance is provided during the plan year, via salary reduction or otherwise.

(ii) *Employees taken into account*. For purposes of applying the calculation in paragraph (d)(2)(i) of this section, any individual employed by the employer on any day of the plan year is taken into account in the denominator if:

(A) The employer provides any amount of dependent care assistance to that employee during the plan year, via salary reduction or otherwise; and

(B) The employee is not described in paragraph (f) of this section.

(3) *Time to perform nondiscrimination test*. The requirements of this paragraph (d) must be satisfied as of the last day of the plan year.

(4) *Salary reduction agreements*. For purposes of this paragraph (d), in the case of any benefits provided through a salary reduction agreement, a plan may disregard any employee whose compensation is less than $25,000. For purposes of this paragraph (d)(4), the term "compensation" has the meaning given such term by section 414(q)(4).

(e) *Utilization rates*. Notwithstanding paragraph (d)(2)(ii) of this section, utilization rates are taken into account to the extent provided in section 129(e)(6) in determining whether a plan satisfies section 129(d)(4) and (8).

(f) *Excluded employees*. For purposes of paragraphs (b) and (d) of this section, there shall be excluded from consideration—

(1) Subject to rules similar to the rules of section 410(b)(4), employees who have not attained the age of 21 and completed one year of service (as defined in section 410(a)(3)); and

(2) Employees not included in a dependent care assistance program who are included in a unit of employees covered by an agreement that the Secretary finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that dependent care benefits were the subject of good faith bargaining between such employee representatives and such employer or employers.

(g) *Contributions taken into account*. For purposes of paragraphs (a) through (d) of this section, an employer's payment or reimbursement for an employee's dependent care outside any dependent care assistance program is not taken into account.

(h) *Effect of failure*. Except as otherwise provided in paragraph (j) of this section, if a plan would qualify as a dependent care assistance program but for a failure to satisfy one or more of the requirements of section 129(d) and this section, then the plan is not a dependent care assistance program with respect to HCEs. Notwithstanding such failure, the plan is treated as a dependent care assistance program with respect to employees who are NHCEs.

(i) [Reserved]

(j) *Correction of nondiscrimination failures*—(1) *In general*. If a plan fails the requirements of the nondiscrimination tests of paragraphs (c) or (d) of this section as of the last day of the plan year, the plan may nonetheless be treated as satisfying the requirements if the plan takes remedial action as described in paragraph (j)(2) (with respect to HCEs) or (j)(3) (with respect to principal shareholders and owners) of this section.

(2) *Remedial measures to correct average benefits testing failures*—(i) *Correction*. If a plan fails to satisfy the requirements of paragraph (d) of this section as of the last day of the plan year, the plan may be treated as satisfying those requirements by including in income any excess benefit amounts received by HCEs. For this purpose, an excess benefit amount is included in income if the amount is treated by the employer as gross income and, to the extent applicable, wages within the meaning of sections 3401, 3121, and 3306, and compensation within the meaning of section 3231, and reported as such with respect to the year being tested by the deadline prescribed in § 31.6051-1(d)(1)(i) of this chapter for furnishing statements on Form W-2, *Wage and Tax Statement*, for the year in which the excess benefits were received.

(ii) *Allocation of excess benefits*.

(A) If all HCEs have dependent care benefits in excess of the quotient of the amount of the average dependent care benefits of all NHCEs divided by 0.55, the amount of excess benefits to be included in income of each HCE is the excess of the amount of that HCE's dependent care benefit over that quotient.

(B) If not all HCEs have dependent care benefits in excess of the quotient of the amount of the average dependent care benefits of all NHCEs divided by 0.55, the plan may allocate the reduction of dependent care benefits among HCEs in any reasonable manner, including methods for apportioning distributions of excess amounts similar to those used in § 1.401(k)-2(b)(2)(iii).

(3) *Remedial measures to correct principal shareholders and owners concentration failures*—(i) *Correction*. If a plan fails to satisfy the requirements of paragraph (c) of this section as of the last day of the plan year, the plan may be treated as satisfying those requirements by including in income any excess ownership concentration as defined in paragraph (j)(3)(ii) of this section. For this purpose, an excess ownership concentration is included in income if the amount is treated by the employer as gross income and, to the extent applicable, wages within the meaning of sections 3401, 3121, and 3306, and compensation within the meaning of section 3231, and reported as such with respect to the year being tested by the deadline prescribed in § 31.6051-1(d)(1)(i) of this chapter for furnishing statements on Form W-2, *Wage and Tax Statement*, for the year in which the excess ownership concentration was received.

(ii) *Allocation of excess ownership concentration*.

(A) If each of the principal shareholders or owners has dependent care benefits in excess of the permitted concentration amount, the excess ownership concentration for each such individual is the dependent care benefits received by that individual less the permitted concentration amount. For this purpose, the permitted concentration amount is 25 percent of the total dependent care benefits provided by the employer to all participants during the year divided by the number of such individuals to whom benefits were provided.

(B) If not all principal shareholders or owners have dependent care benefits in excess of the permitted concentration amount, the plan may allocate the reduction of dependent care benefits among such individuals in any reasonable manner, including methods for apportioning distributions of excess amounts similar to those used in § 1.401(k)-2(b)(2)(iii).

(k) *Examples*. The following examples illustrate the rules of this section.

(1) *Example 1.* For 2026, an employer has 15 HCEs and 15 NHCEs. The employer maintains a dependent care assistance program funded solely via salary reduction elections made by employees under the employer's section 125 cafeteria plan. All 30 employees are eligible to make salary reduction elections under the plan on the same terms. Eleven of the HCEs elect benefits under the plan of $7,500 each, and four of the NHCEs elect benefits under the plan of $7,500 each. The remaining employees elect no benefits under the plan. The average benefits provided to the HCEs is $7,500 ($82,500/11) and the average benefits provided to the NHCEs is also $7,500 ($30,000/4). Accordingly, the average benefits provided to the NHCEs is 100 percent of the average benefits provided to the HCEs, and the required threshold of 55 percent under section 129(d)(8) and paragraph (d)(1) of this section is satisfied.

(2) *Example 2.* An employer has 15 HCEs and 15 NHCEs. The employer maintains a dependent care assistance program funded solely via salary reduction elections made by employees under the employer's section 125 cafeteria plan. All 30 employees are eligible to make salary reduction elections under the plan on the same terms. Eleven of the HCEs elect benefits under the plan of $7,500 each for a collective $82,500 in benefits provided to eleven HCEs, and an average benefits provided to HCEs of $7,500 ($82,500/11); one of the NHCEs elects benefits of $7,500; three of the NHCEs elect benefits of $5,000; one of the NHCEs elects benefits of $2,500; and two of the NHCEs elect benefits of $1,000, for a collective $27,000 in benefits provided to seven NHCEs, and an average benefits provided to NHCEs of $3,857.14 ($27,000/7). Accordingly, the average benefits provided to the NHCEs is 51.4 percent of the average benefits provided to the HCEs ($3,857.14/$7,500), and the required threshold of 55 percent under section 129(d)(8) and paragraph (d)(1) of this section is not satisfied.

(3) *Example 3.* The facts are the same as in paragraph (k)(2) of this section (*Example 2*) except that the following four NHCEs are excluded employees within the meaning of paragraph (f) of this section: two of the NHCEs who elected benefits under the plan of $5,000; and the two NHCEs who elected benefits of $1,000. With the exclusion of these employees, a collective $15,000 in benefits are provided to three NHCEs, and the average benefits provided to NHCEs is $5,000 ($15,000/3). The average benefits provided to the HCEs is $7,500 ($82,500/11). Accordingly, the average benefits provided to the NHCEs is 66.7 percent of the average benefits provided to the HCEs ($5,000/$7,500), and the required threshold of 55 percent under section 129(d)(8) and paragraph (d)(1) of this section is satisfied.

(4) *Example 4.* The facts are the same as in paragraph (k)(2) of this section (*Example 2*) except that on or before the furnishing deadline for the Form W-2 for the year in which the benefits were provided, the employer treats $500 of the benefits elected by each of the HCEs as gross income and wages for the year in which the benefits were provided, reducing the benefits provided to the HCEs to a collective $77,000 in benefits provided to 11 HCEs, reducing the average benefit to HCEs to $7,000 ($77,000/11). Accordingly, the average benefits provided to the NHCEs is 55.1 percent of the average benefits provided to the HCEs ($3,857.14/$7,000), and the required threshold of 55 percent under section 129(d)(8) and paragraph (d)(1) of this section is satisfied.

(5) *Example 5.* The facts are the same as in paragraph (k)(1) of this section (*Example 1*) except that the 11 NHCEs to whom benefits are not provided are not eligible to elect benefits under the terms of the plan. The 11 excluded NHCEs are not excluded employees within the meaning of section 129(d)(9) and paragraph (f) of this section. The plan has discriminated in favor of HCEs as to eligibility and thus does not satisfy the requirements of section 129(d)(3) and paragraph (b) of this section.

(l) *Applicability date*. This section applies to plan years beginning on or after the date of publication of the final rule in the **Federal Register**.

Frank J. Bisignano,
Chief Executive Officer.

(Filed by the Office of the Federal Register August 10, 2026, 8:45 a.m., and published in the issue of the Federal Register for August 11, 2026, 91 FR 51611)

Notice of Proposed Rulemaking

Foreign Currency Gain or Loss of Controlled Foreign Corporations

REG-103844-26

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations providing rules relating to the determination and recognition of foreign currency gain or loss with respect to qualified business units ("QBUs") of controlled foreign corporations ("CFCs"). The proposed regulations provide an election under which a CFC generally would not be required to compute or recognize foreign currency gain or loss upon a remittance from a QBU,

except in connection with certain inbound nonrecognition transactions.

DATES: Written or electronic comments and requests for a public hearing must be received by November 12, 2026.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG-103844-26) by following the online instructions for submitting comments. Requests for a public hearing must be submitted as prescribed in the "Comments and Requests for a Public Hearing" section. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments submitted to the IRS's public docket. Send paper submissions to: CC:PA:01:PR (REG-103844-26), Room 5503, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Mark Terrell at (202) 317-6938; concerning submissions of comments or requests for a public hearing, the Publications and Regulations Section at (202) 317-6901 (not toll-free numbers) or by e-mail at *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Authority

This document contains proposed additions and amendments to 26 CFR part 1 (Income Tax Regulations) addressing the application of section 987 of the Internal Revenue Code ("Code") and related provisions (the "proposed regulations"). The additions and amendments are issued under sections 987 and 989, pursuant to the express delegations of authority provided under those sections. The express delegations relied upon are referenced in the Background section of this preamble. The proposed regulations are also issued under the express delegation of authority under section 7805(a).

Background

I. *Overview*

Section 987 applies to any taxpayer that has a qualified business unit ("QBU") with a functional currency other than the dollar. Section 987(1) and (2) provide rules for determining and translating taxable income or loss ("section 987 taxable income or loss") with respect to a QBU that is subject to section 987 ("section 987 QBU"). In addition, section 987(3) requires proper adjustments (as prescribed by the Secretary) for transfers of property between QBUs of the taxpayer having different functional currencies (including transfers of property between a controlled foreign corporation ("CFC") and its QBUs). Under section 987(3), a taxpayer that owns a QBU generally must recognize foreign currency gain or loss ("section 987 gain or loss") upon a remittance from the QBU.

Sections 987 and 989 provide several explicit grants of regulatory authority. Section 987(3) directs the Secretary to prescribe proper adjustments for transfers of property between QBUs of the taxpayer having different functional currencies. Section 989(c) directs the Secretary to "prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subpart."[1]

On December 11, 2024, the Treasury Department and the IRS published Treasury Decision 10016, which contained final regulations under sections 861, 985, 987 through 989, and 1502 (the "2024 final regulations"), in the **Federal Register** (89 FR 100138). Concurrently with the publication of the 2024 final regulations, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-117213-24) under section 987, which addressed the treatment of frequently recurring disregarded transactions (the "2024 proposed regulations"), in the **Federal Register** (89 FR 99782).

On February 25, 2026, the Treasury Department and the IRS issued Notice 2026-17, 2026-12 IRB 698, which announced that proposed regulations would be issued under section 987 for the purpose of simplifying the operation of the 2024 final regulations, reducing compliance burdens, and refining the scope of certain rules under section 987 to limit their effect on ordinary course transactions.

II. *Application of Section 987 to Controlled Foreign Corporations*

A. *2024 final regulations*

The 2024 final regulations provide that section 987(3) and the related regulations apply to CFCs in which at least one United States shareholder ("U.S. shareholder"), within the meaning of section 951(b), directly or indirectly owns stock, within the meaning of section 958(a). *See* § 1.987-1(b)(1).

B. *2024 proposed regulations*

The preamble to the 2024 proposed regulations requested comments as to whether the final regulations should be modified to provide that section 987(3) does not apply to CFCs. The preamble explained that, when a United States person ("U.S. person") owns a section 987 QBU, foreign currency gain or loss must be recognized under section 987(3) in order to accurately measure the U.S. person's accession to wealth in U.S. dollars. By contrast, alternative rules may be appropriate in the case of a section 987 QBU owned by a CFC, because a CFC is permitted to compute its income in a functional currency other than the dollar. *See* section 985(b).

In the preamble to the 2024 proposed regulations, however, the Treasury Department and the IRS also expressed concern that, if section 987(3) were not applied to a section 987 QBU owned by a CFC, the CFC's basis in assets distributed from the section 987 QBU could be increased or reduced due to exchange rate fluctuations. This is because, in the absence of special

[1] The reference to "this subpart" refers to subpart J of part III of subchapter N of chapter 1 of the Code, which includes section 987.

rules requiring the CFC to track basis in the section 987 QBU's assets using historic exchange rates, the CFC's basis in assets distributed by the section 987 QBU would be translated at the spot rate on the date of the distribution. If the U.S. shareholders of the CFC were then to ultimately sell their CFC stock in a taxable transaction, the gain or loss recognized on the sale generally would reflect any economic foreign currency gain or loss attributable to the distributed assets. However, in the case of an inbound liquidation or reorganization, asset basis attributable to appreciation in the value of the section 987 QBU's functional currency could be imported into the United States without a corresponding income inclusion. As a result, economic foreign currency gain with respect to the assets distributed by the section 987 QBU would permanently escape U.S. taxation.

C. *Comments received in response to the 2024 proposed regulations*

The Treasury Department and the IRS received several comments in response to the 2024 proposed regulations. Two of the commenters requested that CFCs be excluded completely from the application of section 987(3). The commenters noted that section 987(3) provides the Secretary with discretion to determine the nature of the proper adjustments required to account for foreign currency gain or loss with respect to a QBU. The commenters asserted that, if section 987(3) did not apply to CFCs, foreign currency gain or loss with respect to a section 987 QBU of a CFC typically would be accounted for under other provisions of the Code (for example, under section 301(c)(3)). Therefore, according to the commenters, it would not be necessary for a CFC to separately recognize section 987 gain or loss.

D. *Notice 2026-17*

Notice 2026-17 announced that the Treasury Department and the IRS intend to issue forthcoming proposed regulations that would provide an election under which CFCs generally would not compute or recognize section 987 gain or loss with respect to their section 987 QBUs. The Notice described the rules and procedures for making the election (including consistency requirements) that would apply under the proposed regulations. The Notice explained that, under the rules of the proposed regulations, unrecognized section 987 gain or loss of a CFC arising before the election was made would be amortized over a period of 120 months, consistent with the elective rules for amortizing pretransition gain or loss under the 2024 final regulations. *See* § 1.987-10(e)(5)(ii). The Notice further explained that the proposed regulations would require taxpayers to account for foreign currency gain (but not loss) in the case of an inbound liquidation or reorganization described in § 1.367(b)-3(a) of a CFC that is subject to the election.

Although Notice 2026-17 summarized the rules that would be provided in the proposed regulations relating to the CFC election and its consequences, the Notice did not describe these rules in detail. In addition, the Notice did not permit taxpayers to rely on the rules relating to the CFC election.

Notice 2026-17 also announced that the proposed regulations would (i) permit taxpayers to determine section 987 taxable income or loss and section 987 gain or loss using an equity and basis pool method that is substantially similar to the method provided in regulations proposed in 1991; (ii) narrow the scope of the loss suspension rules; (iii) simplify the loss-to-the-extent-of-gain rule under which suspended section 987 loss is recognized; (iv) modify the definition of a successor for purposes of the deferral rules; and (v) expand the definition of a section 987 hedging transaction. The Notice described rules expected to be included in the proposed regulations regarding these issues and provided that taxpayers are permitted to rely on these rules. Proposed regulations addressing these provisions of Notice 2026-17 will be included in a future notice of proposed rulemaking.

E. *Comments received in response to Notice 2026-17*

The Treasury Department and the IRS received a number of comments in response to Notice 2026-17. The commenters generally requested that guidance relating to the CFC election be issued as quickly as possible, so that taxpayers have sufficient time to make the election for the 2025 taxable year. Several of the recommendations made by the commenters are addressed in the Explanation of Provisions section of this preamble. The Treasury Department and the IRS are continuing to evaluate the remaining comments and will address these comments in future guidance.

III. *Election to Amortize Pretransition Gain or Loss*

The 2024 final regulations provide transition rules for the determination and recognition of section 987 gain or loss that arose before the 2024 final regulations became applicable ("pretransition gain or loss"). *See* § 1.987-10. In particular, under § 1.987-10(e)(5)(ii)(A), taxpayers can elect to recognize pretransition gain or loss ratably over the transition period (the "amortization election"). Under the 2024 final regulations, the transition period is a period of ten taxable years beginning with the first taxable year in which the section 987 regulations apply. Therefore, a taxpayer that makes the amortization election recognizes one tenth of its pretransition gain or loss in each year of the transition period, including short taxable years.

In Notice 2025-72, 2025-51 IRB 840, the Treasury Department and the IRS announced that proposed regulations would modify the effect of the amortization election for short taxable years by providing that pretransition gain or loss is recognized ratably over a period of 120 months. Thus, for example, in a one-month short taxable year, the owner would recognize 1/120th (rather than one tenth) of its pretransition gain or loss.

Explanation of Provisions

I. *CFC Exemption Election*

A. *Overview*

Consistent with Notice 2026-17, the proposed regulations would permit taxpayers to make an election ("CFC exemption election") that would limit the application of section 987(3) and the related regulations with respect to CFCs. Proposed § 1.987-15. In a taxable year to which the election applies, a CFC generally would not compute or recognize section 987 gain or loss, except in connection with certain inbound nonrecognition transactions. Proposed § 1.987-15(b). However, the rules of section 987(1) and (2) would continue to apply, for example, for purposes of computing the taxable income and earnings and profits of the CFC.

The CFC exemption election is intended to reduce the compliance and administrative burdens of applying section 987(3) with respect to section 987 QBUs owned by CFCs. Additional flexibility is warranted in this context because, under section 985, many CFCs have a functional currency other than the U.S. dollar; thus, a CFC's income is not necessarily measured by its accession to wealth in U.S. dollar terms. Moreover, if a CFC does not recognize section 987 gain or loss with respect to a section 987 QBU, the economic currency gain or loss with respect to the section 987 QBU generally should be taken into account by the CFC's U.S. shareholders under other provisions of the Code (for example, in the case of a taxable sale of the CFC stock, under section 1001), such that the U.S. shareholders would, over time, recognize the correct amount of total income with respect to the CFC.

Section 987(3) provides broad authority to prescribe proper adjustments for transfers of property between QBUs of the taxpayer having different functional currencies. Section 989(c) also provides broad authority to "prescribe such regulations as may be necessary or appropriate to carry out the purposes" of subpart J. The Treasury Department and the IRS are of the view that this authority allows for special elective rules to be prescribed with respect to CFCs that are different from the rules applicable to U.S. persons.

The proposed regulations would provide that, for taxable years in which the CFC exemption election is in effect, a CFC generally would not compute or recognize section 987 gain or loss. However, as explained in parts I.E and I.G of this Explanation of Provisions, a CFC would continue to compute and recognize section 987 gain or loss that arises in taxable years for which the CFC exemption election is not in effect, and a CFC would be required to recognize section 987 gain in connection with certain inbound transactions when a CFC exemption election is in effect.

B. *Rules for making and revoking the election*

1. In general

A CFC exemption election would be a section 987 election within the meaning of § 1.987-1(g) and, therefore, would be subject to the general rules for making and revoking elections under § 1.987-1(g). In general, the election would be made by filing an election statement before the start of the taxable year. Proposed § 1.987-1(g)(3)(ii)(D)(*3*). However, as described in part I.B.2 of this Explanation of Provisions, the proposed regulations would provide special rules for taxable years beginning after December 31, 2024, and ending on or before December 31, 2027. The CFC exemption election could not be revoked without the consent of the Commissioner. *See* § 1.987-1(g)(3)(ii)(A).

2. Taxable years beginning after December 31, 2024, and ending on or before December 31, 2027

Notice 2026-17 stated that the CFC exemption election would generally be made on an original, timely filed return (including extensions). Commenters noted that many calendar year taxpayers will already have finished preparing their original tax returns for the 2025 taxable year by the time the proposed regulations are issued. The commenters asserted that it may be difficult for these taxpayers to make the computations needed to account for the CFC exemption election on their timely filed original tax returns for the 2025 taxable year. Two commenters recommended that, for taxable years beginning in 2025, taxpayers should be permitted to make the CFC exemption election on an amended return filed before a specified date (either the original tax return due date, with extensions, for the 2026 taxable year, or when final regulations are published).

The Treasury Department and the IRS agree that additional flexibility is appropriate in making the CFC exemption election for the 2025 taxable year. In addition, the Treasury Department and the IRS acknowledge that transition issues may also arise for the 2026 and 2027 taxable years. Accordingly, the proposed regulations provide special election timing rules for taxable years beginning after December 31, 2024, and ending on or before December 31, 2027.

In general, for taxable years beginning after December 31, 2024, and ending on or before December 31, 2026, the authorized person (within the meaning of § 1.987-1(g)(1)) would make the CFC exemption election by attaching an election statement to its original, timely filed (including extensions) return. Proposed § 1.987-1(g)(3)(ii)(D)(*1*). Alternatively, for taxable years beginning in 2025, taxpayers would be permitted to make the CFC exemption election on an amended return filed by October 15, 2027. *Id.*

For taxable years ending in 2027, the authorized person would make the CFC exemption election by filing the election statement on or before October 15, 2027. Proposed § 1.987-1(g)(3)(ii)(D)(*2*). Thus, until October 15, 2027, a calendar year taxpayer would be permitted to make the election for the 2025, 2026, or 2027 taxable years.

This timetable is intended to provide sufficient time for taxpayers to determine whether to make the CFC exemption election after the issuance of final regulations providing for the election, while ensuring that the deadline for any of these three taxable years does not fall earlier than the deadline for a preceding taxable year. The general rule contained in proposed § 1.987-1(g)(3)(ii)(D)(*3*) would apply for taxable years ending after December 31, 2027. Thus, a calendar year taxpayer would be required to make a CFC exemption election for the 2028 taxable year on or before December 31, 2027.

3. Taxable year for which the CFC exemption election first becomes relevant

As an alternative to the rules described in parts I.B.1 and I.B.2 of this Explanation of Provisions, for the taxable year in which the CFC exemption election first becomes relevant, the authorized person could also make a CFC exemption election by attaching an election statement to its original, timely filed (including extensions) return. Proposed § 1.987-1(g)(3)(ii)(D)(*4*). This rule would provide additional time to make the election if the CFC exemption election first becomes relevant for a taxable year ending after December 31, 2026.

For this purpose, the CFC exemption election first becomes relevant in the first taxable year beginning after December 31, 2024, in which the authorized person's section 987 electing group includes a CFC that is the owner of a section 987 QBU. Thus, for example, the alternative rule in proposed § 1.987-1(g)(3)(ii)(D)(*4*) could apply to a taxable year beginning after December 31, 2024, in which a domestic corporation acquired all the stock of a CFC that owned a section 987 QBU, but only if the domestic corporation did not own a majority of the stock of any other CFC that owned a section 987 QBU in any previous taxable year beginning after December 31, 2024.

C. *Consistency requirements*

1. In general

Under § 1.987-1(g)(2)(ii), section 987 elections must be made consistently for all members of a section 987 electing group, including all CFCs in which a majority of the stock, by vote or value, is owned (within the meaning of section 958(a)) by the same U.S. shareholder. When a CFC joins a section 987 electing group, it is deemed to make or revoke any section 987 election as necessary to be consistent with the other group members.

The proposed regulations would provide additional consistency requirements to ensure that this election is made on a uniform basis for all CFCs that are commonly controlled by affiliated U.S. shareholders. Under proposed § 1.987-15(c)(2)(i), all domestic corporations that are affiliated (within the meaning of § 1.904(i)-1(b)) would be required to make consistent CFC exemption elections with respect to their majority-owned CFCs. This rule would require consistent CFC exemption elections between certain related but non-consolidated domestic corporations. For example, proposed § 1.987-15(c)(2)(i) would require consistency between separate consolidated groups that are commonly owned by a foreign parent corporation, and between domestic corporations that would be members of the same consolidated group but for the interposition of a partnership. In addition, under proposed § 1.987-15(c)(2)(ii), a U.S. person would be treated as owning CFC stock that it holds indirectly through a domestic partnership (by treating a domestic partnership in the same manner as a foreign partnership in applying section 958(a)).

The proposed regulations also would provide anti-avoidance rules to prevent taxpayers from entering into related-party transactions designed to avoid the consistency requirements or trigger a deemed revocation of a CFC exemption election. Proposed § 1.987-15(c)(3).

2. Acquisitions

A commenter requested additional guidance regarding the application of the consistency rules when a CFC that is not subject to a CFC exemption election (or its U.S. shareholder) is acquired by an unrelated party that has made a CFC exemption election (or vice versa). The commenter noted that, when an acquirer with minimal section 987 exposure acquires a CFC that owns a substantial number of section 987 QBUs, it may not be appropriate for the acquirer's elections to remain in effect. The commenter suggested that guidance be provided either solely with respect to the CFC exemption election or with respect to section 987 elections more generally.

The Treasury Department and the IRS are continuing to study the appropriate application of the consistency rules in § 1.987-1(g) and proposed § 1.987-15(c) to cases in which a CFC (or another domestic or foreign entity) is acquired by an unrelated party. The Treasury Department and the IRS request comments on this issue in general, including whether special rules should be provided for cases in which an acquired CFC's taxable year does not end at the time of the acquisition and to coordinate the consistency rules with the statutory changes (including the modifications to the pro rata share rules) in Public Law 119-21, 139 Stat. 72 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA), and the related regulations.

D. *Effect of the CFC exemption election*

1. In general

If a CFC is subject to a CFC exemption election (an "exempt CFC"), the rules of the section 987 regulations relating to the determination and recognition of section 987 gain or loss (for example, §§ 1.987-4 through 1.987-6 and 1.987-11 through 1.987-14) generally would not apply to the exempt CFC. Proposed § 1.987-15(b)(2). However, other parts of the section 987 regulations (for example, § 1.987-3, which relates to the determination of section 987 taxable income or loss) would continue to apply to the exempt CFC. Thus, for example, a taxpayer could make an election to use a spot rate convention under § 1.987-1(c)(1)(ii) or a section 988 mark-to-market election under § 1.987-3(b)(4)(ii) with respect to an exempt CFC.

The applicable rules of the section 987 regulations would be applied by deeming a current rate election to be in effect with respect to each exempt CFC, so that exempt CFCs would not be required to track historic exchange rates. Proposed § 1.987-15(b)(3)(i). As a result, the amount of a section 987 QBU's taxable income or loss would be translated into the owner's functional currency at the yearly average exchange rate, and transfers between a section 987 QBU and its owner would be translated at the spot rate applicable on the date of the transfer.

2. Partnerships owned by CFCs

a. Rules of the 2024 final regulations relating to partnerships

The 2024 final regulations do not provide detailed rules concerning the determination of section 987 taxable income or loss and section 987 gain or loss in the case of a partnership. Thus, taxpayers must apply sections 987 and 989(a) with respect to partnerships using a reasonable method consistent with the statute, and this method must be applied consistently from year to year. *See* § 1.987-7(b).

For example, assume a CFC with the U.S. dollar as its functional currency owns an interest in a foreign partnership that would be viewed as using the euro as its functional currency if the partnership were treated as a QBU under section 989(a), and the partnership owns an eligible QBU that uses the Swiss franc as its functional currency. The CFC could apply section 987 using an aggregate approach, under which the CFC is treated as the indirect owner of its proportionate interest in the eligible QBU. Alternatively, under an entity approach, the partnership itself could be treated as a section 987 QBU of the CFC, and the eligible QBU could be treated as a section 987 QBU of the partnership.

b. Rules of the proposed regulations relating to partnerships owned by CFCs

The proposed regulations would provide rules relating to the effect of a CFC exemption election when an exempt CFC is a partner in a partnership. These rules generally are intended to provide parity between the treatment of a section 987 QBU that is directly owned by an exempt CFC and the treatment of a section 987 QBU that is owned by (or through) a partnership whose partners are exempt CFCs.

Under proposed § 1.987-7(b)(2), an exempt CFC generally would not compute or recognize section 987 gain or loss with respect to an "exempt partnership QBU," which would be defined to include (i) a partnership that is treated as a section 987 QBU of an exempt CFC or (ii) a section 987 QBU that is indirectly owned by an exempt CFC through a partnership. Proposed § 1.987-7(b)(2)(iii). However, an exempt CFC would be required to continue to apply the rules of sections 987(1) and (2) and 989(a) with respect to its exempt partnership QBUs in a reasonable manner using a method that is applied consistently from year to year. Proposed § 1.987-7(b)(2).

Similarly, if a partnership is treated as the owner of a section 987 QBU, and at least 80 percent of the capital or profits interests in the partnership are owned by exempt CFCs that are members of the same controlled group (an "exempt partnership"), the section 987 QBU would be an exempt partnership QBU, and the exempt partnership generally would not compute or recognize section 987 gain or loss with respect to the exempt partnership QBU. Proposed § 1.987-7(b)(2)(iii) and (iv). However, the exempt partnership would be required to continue to apply the rules of sections 987(1) and (2) and 989(a) in a reasonable manner using a method that is applied consistently from year to year. Proposed § 1.987-7(b)(2). Thus, an exempt partnership generally would be treated in the same manner as an exempt CFC for purposes of section 987. For this purpose, an exempt CFC would be treated as owning a partnership interest that it holds indirectly through one or more other partnerships. Proposed § 1.987-7(b)(2)(ii).

If a partnership meets the definition of an exempt partnership in the taxable year in which a CFC exemption election is made, the rules of proposed § 1.987-15 would apply to the exempt partnership beginning in that taxable year. If a partnership becomes an exempt partnership in a later taxable year (for example, because an exempt CFC acquires an interest in the partnership), the rules of proposed § 1.987-15 would be applied to the exempt partnership by treating the CFC exemption election as having been made for that taxable year. Proposed § 1.987-15(g)(3)(iii). Similarly, in a taxable year in which a partnership ceases to be treated as an exempt partnership (for example, because an exempt CFC disposes of its partnership interest), the rules of proposed § 1.987-15 would be applied to the partnership by treating the CFC exemption election as having been revoked for that taxable year. Proposed § 1.987-15(g)(3)(iv).

E. *Pre-election section 987 gain or loss*

1. Requirement to compute and amortize pre-election section 987 gain or loss

a. Comments received in response to Notice 2026-17

Notice 2026-17 explained that, beginning in the first taxable year in which a CFC exemption election is made, unrecognized section 987 gain or loss that arose in previous taxable years ("pre-election section 987 gain or loss") would be amortized over a period of 120 months. The Treasury Department and the IRS received several comments recommending that taxpayers be permitted to elect whether or not to compute and recognize pre-election section 987 gain or loss. The commenters posited that, if the CFC exemption election is intended to prevent the application of section 987(3) with respect to exempt CFCs, then exempt CFCs should not be required to account for section 987 gain or loss that arose before the CFC exemption election was made. Further, the comments asserted that the computation of pre-election section 987 gain or loss would be burdensome for taxpayers.

b. Proposed rules requiring computation and amortization of pre-election section 987 gain or loss

In general, the proposed regulations would require taxpayers to compute and amortize pre-election section 987 gain or loss, and they would not permit taxpayers to elect out of this requirement.[2] See parts I.E.3 and I.E.4 of this Explanation of Provisions for a detailed description of the proposed rules for computing and amortizing pre-election section 987 gain or loss.

Contrary to the commenters' suggestion, the CFC exemption election is intended to narrow, rather than wholly prevent, the application of section 987(3) to exempt CFCs. Thus, the proposed regulations would leave in place the default rule of § 1.987-1(b)(1), which provides that section 987(3) applies to CFCs. However, pursuant to the authority to prescribe proper adjustments under section 987(3), the proposed regulations would provide an election that would limit the circumstances in which an exempt CFC would recognize section 987 gain or loss. An exempt CFC generally would not be required to recognize section 987 gain or loss in taxable years for which the election applies, but it would be required to amortize pre-election section 987 gain or loss, and it may also be required to recognize

[2] As explained in part I.E.1.c of this Explanation of Provisions, the proposed regulations would provide special rules to relieve the compliance burden of computing pre-election section 987 gain or loss with respect to smaller QBUs of exempt CFCs.

section 987 gain in the case of an inbound reorganization or liquidation.

The Treasury Department and the IRS are concerned that the election requested by the commenters would allow taxpayers to eliminate previously computed amounts of section 987 gain or loss in a manner similar to the elective "fresh start" transition method that was provided in earlier proposed regulations under section 987 (the "2006 proposed regulations") that were published in the **Federal Register** in 2006 (71 FR 52876, September 7, 2006). In response to the 2006 proposed regulations, a commenter asserted that this election was overly favorable to taxpayers and would have one-sided effects that would be detrimental to the fisc. Consistent with this comment, the 2024 final regulations require taxpayers to account for pretransition gain or loss under § 1.987-10 and do not permit use of the fresh start transition method on an elective basis. For similar reasons, the Treasury Department and the IRS are of the view that the election requested by the commenters would expose the government to whipsaw. Taxpayers with substantial pre-election section 987 gain could choose to eliminate the gain, while taxpayers with substantial pre-election section 987 loss could amortize the loss over 120 months.

Accordingly, proposed § 1.987-15(e) generally would require taxpayers that make a CFC exemption election to compute pre-election section 987 gain or loss and amortize this gain or loss over a ten-year period. This rule would ensure that section 987 gain or loss arising before the taxable year of the CFC exemption election is properly taken into account.

c. Exception for QBUs with assets of less than $50 million

Although proposed § 1.987-15(e) generally would require taxpayers to compute and recognize pre-election section 987 gain or loss, the Treasury Department and the IRS acknowledge that, depending on the size of a QBU, the burden of this computation may outweigh its rationale. Therefore, the proposed regulations would provide an exception to the general rule of proposed § 1.987-15(e) for QBUs that hold assets of less than $50 million.

Under proposed § 1.987-15(e)(2)(iii), an exempt CFC would be deemed to have zero pre-election section 987 gain or loss with respect to a QBU that has average assets of less than $50 million for the three-year period preceding the first taxable year for which the election is made. *See* proposed § 1.987-15(e)(2)(iii)(B)(*1*). The three-year averaging requirement is intended to prevent inappropriate shifting of assets between QBUs. All QBUs of an exempt CFC or exempt partnership with the same country of residence (as defined in section 988(a)(3)(B)) would be aggregated for purposes of the $50 million threshold. Proposed § 1.987-15(e)(2)(iii)(B)(*3*).

For this purpose, the amount of a QBU's assets for each of the three years preceding the first taxable year for which the CFC exemption election is made would be equal to the amount of total assets reflected on the QBU's U.S. GAAP balance sheet on the last day of the relevant taxable year (which is reported annually on Form 8858, Schedule F). Proposed § 1.987-15(e)(2)(iii)(B)(*2*). Unlike the items attributable to an eligible QBU under § 1.987-2(b)(1), these amounts are not adjusted to conform to Federal income tax principles. Based on available data, the Treasury Department and the IRS anticipate that this exception would substantially reduce the overall compliance burden of computing pre-election section 987 gain or loss.

2. Coordination with the transition rules of § 1.987-10

The rules for computing and recognizing pre-election section 987 gain or loss under proposed § 1.987-15(e) generally would not apply if the CFC exemption election is made for the taxable year beginning on the transition date described in § 1.987-10(c)(1) (that is, the first day of the first taxable year to which the 2024 final regulations apply). In this case, because unrecognized section 987 gain or loss arising before the transition date is already accounted for under the transition rules of § 1.987-10, taxpayers would not be required to separately account for pre-election section 987 gain or loss under proposed § 1.987-15(e). However, because the transition rules of § 1.987-10 do not apply to partnerships, an exempt CFC or exempt partnership would compute pre-election section 987 gain or loss under proposed § 1.987-15(e) with respect to an exempt partnership QBU even when the CFC exemption election is made in the taxable year beginning on the transition date. Proposed § 1.987-15(g)(1)(i).

In general, a CFC exemption election would not affect the application of the transition rules in § 1.987-10. Thus, in the taxable year beginning on the transition date, an exempt CFC would apply § 1.987-10 to determine pretransition gain or loss with respect to its section 987 QBUs. Additionally, the rules cross-referenced in § 1.987-10 (for example, the rules of § 1.987-4 that are cross-referenced in § 1.987-10(e)(3)(iii)) would apply for purposes of the transition rules. However, if the CFC exemption election is made for the taxable year beginning on the transition date, an exempt CFC would be deemed to have no pretransition gain or loss with respect to a QBU that does not meet the $50 million asset threshold under proposed § 1.987-15(e)(2)(iii). Proposed § 1.987-15(d)(2).

A taxpayer that makes a CFC exemption election for the taxable year beginning on the transition date would be deemed to also make the amortization election under § 1.987-10(e)(5)(ii) with respect to its exempt CFCs. Proposed § 1.987-15(d)(1)(i). Because an exempt CFC does not recognize section 987 gain or loss under § 1.987-5 at the time of a remittance, this deemed election is needed to provide a mechanism for recognizing an exempt CFC's pretransition gain or loss. A taxpayer that is deemed to make the amortization election by reason of a CFC exemption election would not be required to make the amortization election with respect to QBU owners that are not exempt CFCs. Proposed § 1.987-15(d)(1)(ii).

3. Computation of pre-election section 987 gain or loss if the CFC exemption election is made after the taxable year beginning on the transition date

a. In general

If a CFC exemption election is made for a taxable year beginning after the transition date, an exempt CFC (or an exempt partnership) generally would be required to compute pre-election section 987 gain or loss with respect to its section 987 QBUs, successor deferral QBUs, and successor suspended loss QBUs as of the last day of the preceding taxable year. Proposed § 1.987-15(e)(2). An exempt CFC's pre-election section 987 gain or loss with respect to a QBU would be equal to 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 QBU on the last day of the preceding taxable year, reduced by amounts recognized in the preceding taxable year. *Id.*

b. Interaction with the annual recognition election

Commenters requested clarification concerning the interaction of an annual recognition election with a CFC exemption election. Under proposed § 1.987-15(e)(2), any section 987 gain or loss recognized before the first taxable year in which the CFC exemption election applies would not be taken into account in computing pre-election section 987 gain or loss. Therefore, if a CFC is subject to an annual recognition election before the CFC exemption election is made, and the CFC does not have any outstanding deferred section 987 gain or loss or cumulative suspended section 987 loss, the CFC's pre-election section 987 gain or loss would be zero (because the CFC's net unrecognized section 987 gain or loss would have been recognized in prior taxable years as a result of the annual recognition election).

4. Recognition of pre-election section 987 gain or loss

An exempt CFC would recognize pre-election section 987 gain or loss ratably over a period of 120 months beginning with the first day of the first taxable year in which the election applies. Proposed § 1.987-15(e)(3)(i). In general, the source and character of pre-election section 987 gain or loss would be determined by applying the rules of § 1.987-6 in the last taxable year before the CFC exemption election takes effect. Proposed § 1.987-6(b)(1)(v). However, deferred section 987 gain or loss and suspended section 987 loss would retain the source and character determined in the taxable year of deferral or suspension, respectively. *See* § 1.987-6(b)(1)(ii) and (iii).

It is possible that a CFC would amortize both pre-election section 987 gain or loss (under § 1.987-15(e)(3)(i)) and pretransition gain or loss (under § 1.987-10(e)(5)(ii)) in certain years. This would be the case, for example, if a calendar year CFC with a transition date of January 1, 2025, made the election to amortize pretransition gain or loss under § 1.987-10(e)(5)(ii) but did not make the CFC exemption election for 2025, and then made the CFC exemption election for 2026. However, if the CFC described in the preceding sentence owned a QBU that held assets of less than $50 million (as determined under proposed § 1.987-15(e)(2)(iii)(B)), the exempt CFC would continue to amortize pretransition gain or loss under § 1.987-10(e)(5)(ii) in 2026 and subsequent years, but would not amortize pre-election section 987 gain or loss with respect to the QBU under proposed § 1.987-15(e)(2)(iii).

5. Conversion of pre-election section 987 gain or loss into suspended section 987 loss

In two cases, pre-election section 987 loss would be converted into suspended section 987 loss. First, under proposed § 1.987-15(e)(3)(iv), if pre-election section 987 loss of an exempt CFC is attributable to a QBU that is owned by a different member of the exempt CFC's controlled group (for example, a successor deferral QBU), and the exempt CFC ceases to be related to the owner of the QBU due to a transfer of the exempt CFC's stock, the pre-election section 987 loss would become suspended section 987 loss. This rule is intended to prevent taxpayers from engaging in loss trafficking by selling an exempt CFC with a pre-election section 987 loss attribute to an unrelated person that does not also acquire ownership of the QBU to which the loss is attributable. When this rule applies, the CFC would recognize the suspended section 987 loss only to the extent of section 987 gain recognized in a taxable year in which it is no longer subject to the CFC exemption election.

Second, under proposed § 1.987-15(f)(2)(ii), pre-election section 987 loss would be suspended if the CFC exemption election is revoked (or deemed to be revoked) during the first 60 months of the amortization period. This rule is intended to prevent taxpayers from making the CFC exemption election for a limited period of time in order to accelerate the recognition of section 987 loss.

6. Exempt partnerships

An exempt partnership generally would be required to compute pre-election section 987 gain or loss in the same manner as an exempt CFC. Proposed § 1.987-15(g)(3)(i). However, the exempt partnership itself would not recognize the pre-election section 987 gain or loss. Instead, each partner in the exempt partnership would take into account its share of the pre-election section 987 gain or loss ratably over a period of 120 months. Proposed § 1.987-15(g)(3)(ii). This rule is designed to prevent pre-election section 987 gain or loss from being shifted to a new partner upon a sale or transfer of a partnership interest.

7. Partnership basis adjustments

Under the existing final regulations, when a partner recognizes section 987 gain or loss with respect to a partnership or an eligible QBU of a partnership, the partner's adjusted basis in the partnership must be adjusted under the principles of sections 704(d) and 705. *See* § 1.987-7(e). Therefore, partnership basis adjustments would be made for each taxable year in which an exempt CFC recognizes pre-election section 987 gain or loss with respect to an exempt partnership QBU (including a taxable year in which an exempt CFC recognizes pre-election section 987 gain or loss of an exempt partnership under proposed § 1.987-15(g)(3)(ii)(A)). The Treasury Department and the IRS request comments on this issue in general, including: whether it would be appropriate for an exempt CFC to instead adjust the basis of its partnership interest by the full amount of its pre-election section 987 gain or loss in the first taxable year in which the CFC exemption election applies; whether the recognition of pre-election section 987 gain or loss should be accelerated when an exempt CFC sells its partnership interest during the 120-month amortization period (including whether rules are needed to ensure that capital loss on the sale of a partnership interest is not converted into ordinary loss); and whether special rules should be provided for cases in which an exempt CFC transfers its partnership interest in a transaction described in section 351 or 721.

F. *First year for which the election is revoked*

In the first year in which a CFC exemption election ceases to apply (for example, because the election is deemed to be revoked under the consistency rules in § 1.987-1(g)(2)), any section 987 QBU owned by the CFC would be deemed to be newly formed on the first day of the taxable year. Proposed § 1.987-15(f)(1). As a result, taxpayers would not be required to compute net unrecognized section 987 gain or loss under § 1.987-4 for previous taxable years in which the CFC exemption election was in effect.

G. *Special Rules for Inbound Nonrecognition Transactions*

1. Requirement to account for foreign currency gain

Notice 2026-17 explained that, under the rules to be provided in the proposed regulations, taxpayers would be required to account for foreign currency gain (but not loss) in the case of an inbound liquidation or reorganization of an exempt CFC. In response to the Notice, some commenters asserted that special rules for inbound transactions were not necessary and should not be included in the proposed regulations, or should be narrowly scoped to address transactions entered into with a principal purpose of abuse. Alternatively, the commenters suggested that symmetrical rules should be provided to account for foreign currency loss when the functional currency of a section 987 QBU depreciates in value. However, one commenter acknowledged that inbound transactions of exempt CFCs could present opportunities for importation of excess asset basis attributable to exchange rate fluctuations, which would implicate longstanding concerns of the Treasury Department and the IRS.

The Treasury Department and the IRS are of the view that rules are needed to prevent the importation of excess asset basis resulting from unrecognized foreign currency gains when the assets of an exempt CFC are acquired in an inbound reorganization or liquidation described in § 1.367(b)-3(a) (an "inbound nonrecognition transaction"). In the absence of such rules, an exempt CFC would not currently recognize section 987 gain pursuant to the CFC exemption election, and could also permanently escape U.S. taxation with respect to economic foreign currency gain in the case of an inbound nonrecognition transaction. The related excess asset basis would be imported into the United States and could allow the domestic acquiring corporation to claim excessive deductions or losses in subsequent taxable years. *See* part II.B of the Background section.

Accordingly, under proposed § 1.987-16, when the assets of an exempt CFC (a "transferor CFC") are acquired in an inbound nonrecognition transaction, the transferor CFC would compute and recognize gain equal to the amount of its "section 987 asset basis." Conceptually, section 987 asset basis is intended to reflect the amount by which the aggregate basis of the assets acquired in the inbound nonrecognition transaction has been increased due to appreciation in the value of a section 987 QBU's functional currency. This rule is consistent with one of the purposes of § 1.367(b)-3, which is to ensure that any asset basis repatriated in an inbound nonrecognition transaction either reflects earnings and profits that have already been subject to tax, or gives rise to an inclusion of income or recognition of gain at the time of the inbound nonrecognition transaction.

The Treasury Department and the IRS are of the view that an anti-abuse rule tied to a taxpayer's subjective intent would not sufficiently address concerns regarding the importation of excess asset basis. Because a CFC does not recognize section 987 gain on remittances from a section 987 QBU when a CFC exemption election is in effect, the CFC should recognize foreign currency gain when excess asset basis attributable to the section 987 QBU is imported into the United States, regardless of the taxpayer's reason for entering into the inbound nonrecognition transaction.

In addition, the proposed regulations do not provide rules under which a transferor CFC would recognize foreign currency loss in connection with an inbound nonrecognition transaction. The Treasury Department and the IRS are concerned that, if such rules were adopted, taxpayers could choose to enter into inbound nonrecognition transactions for the purpose of triggering substantial foreign currency losses. This approach is also consistent with the longstanding treatment under § 1.367(b)-3, which, upon an inbound nonrecognition transaction, requires an inclusion of income or recognition of gain and does not permit a deduction or recognition of loss. *See* §§ 1.367(b)-3(b)(3)(i) and (c)(2) and 1.367(b)-2(d)(1).

2. Computation of section 987 asset basis

a. Comments received in response to Notice 2026-17

Notice 2026-17 identified two potential options for computing section 987 asset basis. Under the first option described in the Notice, section 987 asset basis would equal the transferor CFC's aggregate net unrecognized section 987 gain computed for a lookback period of ten taxable years preceding the inbound transaction, using the simplified method provided in § 1.987-10(e)(3). Under the second option, section 987 asset basis would be equal to the amount of the transferor CFC's excess asset basis computed under § 1.367(b)-3(g)(2)(i).

Two commenters recommended a modified version of the first option described in Notice 2026-17, under which the simplified method provided in § 1.987-10(e)(3) would be applied for only five years (rather than ten) unless taxpayers elected to utilize a ten-year lookback period. Another commenter asserted that the lookback period should not exceed ten years, but did not suggest a shorter period.

Some commenters recommended that the simplified method provided in § 1.987-10(e)(3) should be applied using financial statement balance sheets. The commenters requested clarification as to whether adjustments would need to be made to the financial statement balance sheets for this purpose.

Other commenters suggested that section 987 asset basis be computed using a simplified version of the equity and basis pool method described in Notice 2026-17. One commenter requested that taxpayers be provided the option to compute section 987 asset basis by applying the rules of § 1.987-4(d) in their entirety to all taxable years preceding the inbound nonrecognition transaction.

Some commenters criticized the second option described in Notice 2026-17 (which looks to excess asset basis computed under § 1.367(b)-3(g)(2)(i)) because it does not isolate excess asset basis attributable to foreign currency gain with respect to a section 987 QBU. The commenters requested guidance as to how the foreign currency-related component of excess asset basis ("EAB") could be identified for this purpose. Another commenter, however, asserted that the EAB method would be appropriate for taxpayers that are unable to use other methodologies due to data limitations.

Several commenters suggested that the cumulative translation adjustment ("CTA") computed under GAAP could be used as a reasonable proxy for the amount of section 987 asset basis. The commenters requested guidance as to adjustments that would need to be made to the CTA amount for this purpose. One commenter recommended that taxpayers be permitted to use the CTA to compute section 987 asset basis only if the CTA methodology used for GAAP purposes is substantially similar to the computations required under section 987. However, the Treasury Department and the IRS also received feedback indicating that, as a result of remittances, disregarded transactions, and other factors, there can be significant book-to-tax differences between the CTA amount and section 987 gain or loss amounts, and it may not be feasible to provide administrable rules for making the necessary book-to-tax adjustments.

b. Proposed rules for computing section 987 asset basis

The proposed regulations would provide rules for determining a transferor CFC's section 987 asset basis using administrable proxies based on information that is expected to be readily available at the time of the inbound nonrecognition transaction. These rules are intended to avoid the need for retroactive application of the rules of § 1.987-4 (for determining net unrecognized section 987 gain or loss) to prior taxable years based on historical information. The Treasury Department and the IRS are of the view that an approximation is appropriate in this context, given the limited circumstances under which the determination would be necessary (in light of the likely nonrecurring aspect of an inbound nonrecognition transaction) and the potential compliance and administrative burdens of requiring a precise calculation.

In particular, proposed § 1.987-16(c) would require the transferor CFC to determine its section 987 asset basis under one of two methodologies. The transferor CFC would establish its choice of methodology with respect to an inbound nonrecognition transaction by applying that methodology in computing the amount of section 987 asset basis (if any) to be recognized under proposed § 1.987-16(d)(1) with respect to the inbound nonrecognition transaction.

Under the first methodology (the "lookback methodology"), section 987 asset basis would be equal to the aggregate net amount of unrecognized section 987 gain computed using the simplified method provided in § 1.987-10(e)(3) for taxable years ending within the 72-month period preceding the inbound nonrecognition transaction (excluding any taxable year predating the CFC exemption election). Proposed § 1.987-16(c)(2). This approach is expected to capture the appropriate amount of foreign currency gain for those taxable years with a reasonable degree of accuracy. In response to comments, the proposed regulations would provide for a lookback period of only 72 months (rather than ten years) in order to reduce the compliance burden of computing section 987 asset basis.

Under the second methodology, section 987 asset basis would be equal to the amount of EAB with respect to the transferor CFC determined under the rules of § 1.367(b)-3(g)(2)(i) (but without regard to the application of proposed § 1.987-16). Proposed § 1.987-16(c)(3). This approach relies on asset basis amounts determined at the time of the inbound nonrecognition transaction, rather than historical section 987 computations, and therefore may be simpler for taxpayers to apply in some cases. The other components of the EAB formula—earnings and profits and outside stock basis—are also expected to be available at the time of the inbound nonrecognition transaction. However, the Treasury Department and the IRS acknowledge that this approach can result in an imprecise amount of section 987 asset basis (for example, when the transferor CFC has excess asset basis for reasons unrelated to, or in addition to, exchange rate fluctuations).

The Treasury Department and the IRS are continuing to study whether, in addition to the two methodologies described in proposed § 1.987-16(c), other alternative methodologies recommended by commenters could be used to compute a transferor CFC's section 987 asset basis. Accordingly, the comments described in part I.G.2.a of this Explanation of Provisions may be addressed further in future guidance.

3. Gain recognition

a. In general

Under proposed § 1.987-16(d)(1), a transferor CFC would recognize section 987 gain equal to the amount of its section 987 asset basis immediately before the inbound nonrecognition transaction. This rule aligns with the rules that apply when a CFC exemption election is not in effect. In particular, under § 1.987-8, all section 987 QBUs owned by a CFC are treated as terminated immediately before an inbound nonrecognition transaction, and any net unrecognized section 987 gain is recognized by the CFC at that time.

An example in the proposed regulations would confirm that section 987 gain recognized under proposed § 1.987-16(d)(1) is not gain recognized with respect to property distributed in a liquidation within the meaning of section 334(b)(1)(A) (or gain recognized on a transfer of property within the meaning of section 362(b)). *See* proposed § 1.987-16(f)(2)(iii). Under proposed § 1.987-16(d)(1), the section 987 gain would be recognized immediately before the inbound nonrecognition transaction, but not as part of the inbound nonrecognition transaction. Therefore, the domestic acquiring corporation's basis in the property received would not be affected by the recognition of section 987 gain under proposed § 1.987-16(d)(1).[3]

This result is appropriate because section 987 gain recognized under proposed § 1.987-16(d) is intended to reflect the amount by which a CFC's inside asset basis has previously been increased due to exchange rate fluctuations without gain recognition. If the domestic acquiring corporation's asset basis were increased under section 334(b)(1)(A) (or section 362(b)) due to the recognition of section 987 gain under proposed § 1.987-16(d), that would reintroduce the misalignment between asset basis and taxable income or gain that the rules of proposed § 1.987-16 are meant to address.

b. Source and character

The source and character of section 987 gain recognized under § 1.987-16(d) would be determined under § 1.987-6 in the taxable year of recognition. Proposed § 1.987-6(b)(1)(vi). In general, source and character would be determined based on the relative tax book value of all of the transferor CFC's assets. Proposed § 1.987-16(d)(2)(ii). However, stock of a lower-tier subsidiary held by the transferor CFC would not be taken into account for this purpose, because this stock is not attributable to a section 987 QBU under § 1.987-2(b)(2)(i)(A).

c. Comments received in response to Notice 2026-17

In response to Notice 2026-17, the Treasury Department and the IRS received a number of comments regarding the manner in which section 987 asset basis should be taken into account. One commenter recommended that, immediately before the inbound nonrecognition transaction, the basis of the transferor CFC's assets should be reduced by the amount of its section 987 asset basis. Other commenters requested that taxpayers be permitted to elect between different methods for taking into account section 987 asset basis, including (i) gain recognition, (ii) adjustments to asset basis, and (iii) adjustments to the domestic acquiring corporation's net unrecognized section 987 gain or loss following the inbound nonrecognition transaction. The Treasury Department and the IRS are continuing to evaluate these comments. Accordingly, these comments may be addressed in future guidance.

4. De minimis rule

Under the proposed regulations, taxpayers would not be required to compute a transferor CFC's section 987 asset basis, or recognize an amount of section 987 gain equal to the section 987 asset basis, if the aggregate tax basis of the transferor CFC's assets is less than $25 million. Proposed § 1.987-16(e). This de minimis rule is intended to reduce the compliance and administrative burdens of applying § 1.987-16 when a CFC is unlikely to have a significant amount of section 987 asset basis. It is anticipated that the de minimis rule will relieve burdens on small businesses by eliminating the need for taxpayers to determine section 987 asset basis for a significant number of transactions.

In general, the $25 million de minimis threshold is applied with respect to all of a transferor CFC's assets, regardless of whether the assets are attributable to a section 987 QBU at the time of the inbound nonrecognition transaction. This rule is intended to ensure that any assets that may have been previously owned by a section 987 QBU are taken into account for purposes of the de minimis threshold, even if the assets were distributed to the transferor CFC (or the section 987 QBU terminated) before the inbound nonrecognition transaction.

Non-portfolio stock held by the transferor CFC generally would not be taken into account for purposes of the de minimis threshold, because this stock is not attributable to a section 987 QBU under § 1.987-2(b)(2)(i)(A). Proposed § 1.987-16(e)(2). Non-portfolio stock would, however, be taken into account to the extent that other assets of the transferor CFC had been exchanged for such stock (whether or not gain or loss was recognized on the exchange) during the 120-month period preceding the inbound nonrecognition transaction. Thus, for example, if a transferor CFC contributes a section 987 QBU to a lower-tier subsidiary in a section 351 transaction, the basis of the subsidiary stock received by the transferor CFC in exchange for the section 987 QBU would be taken into account under proposed § 1.987-16(e)(2).

The Treasury Department and the IRS received several comments relating to potential de minimis exceptions. One commenter suggested a de minimis rule tied to the amount of the CTA determined for GAAP purposes. Another commenter recommended that a de minimis exception should apply if the transferor CFC's inside asset basis does not exceed 10 percent of the aggregate gross basis of all of the domestic acquiring corporation's assets, or if the amount of section 987 asset basis is less than 10 percent of the transferor CFC's inside asset basis. The Treasury Department and the IRS are continuing to study these comments and will address them in future guidance.

5. Coordination with § 1.367(b)-3(g)

As described in part I.G.2.b of this Explanation of Provisions, the proposed regulations under § 1.987-16 would provide that excess asset basis has the meaning provided in § 1.367(b)-3(g)(2)(i) but is determined prior to the application of § 1.987-16(d). Proposed § 1.987-16(c)(3). To ensure that amounts that give rise to excess asset basis are not double counted (once in applying the proposed regulations under § 1.987-16(d) and again in applying § 1.367(b)-3(g)), § 1.367(b)-3(g)(2)(i) would be modified to provide that excess asset basis generally is determined after the application of § 1.987-16(d).

[3] The same principle would apply with respect to section 987 gain recognized when a section 987 QBU terminates under § 1.987-8.

II. *Amortization of Pretransition Gain or Loss in a Short Taxable Year*

Consistent with Notice 2025-72, proposed § 1.987-10(e)(5)(ii)(A) would provide that an owner that is subject to an amortization election would recognize pretransition gain or loss ratably over a period of 120 months beginning with the first day of the first taxable year in which the section 987 regulations apply. This rule is intended to prevent distortions that could arise from the accelerated recognition of pretransition gain or loss in a short taxable year.

Applicability Dates

The proposed regulations generally are proposed to apply to taxable years ending on or after the date final regulations are filed with the **Federal Register** (the "finalization date"). Proposed § 1.987-10(e)(5)(ii) (relating to the amortization election for pretransition gain or loss) is proposed to apply to taxable years beginning after December 31, 2024, and ending on or after November 25, 2025.

Except as provided in the following sentence, a taxpayer may rely on the proposed regulations for a taxable year beginning after December 31, 2024, and ending before the finalization date, provided that the taxpayer and all members of its consolidated group and section 987 electing group consistently follow the proposed regulations for the taxable year and all subsequent taxable years ending before the finalization date. A taxpayer may rely separately on proposed § 1.987-10(e)(5)(ii) for a taxable year beginning after December 31, 2024, and ending before the finalization date, provided that the taxpayer and all members of its consolidated group and section 987 electing group consistently follow proposed § 1.987-10(e)(5)(ii) for the taxable year and all subsequent taxable years ending before the finalization date.

Special Analyses

I. *Regulatory Planning and Review – Economic Analysis*

Executive Orders 12866 and 13563 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility. This rule is expected to be an Executive Order 14192 deregulatory action.

The proposed regulations have been designated by the Office of Management and Budget's (OMB's) Office of Information and Regulatory Affairs (OIRA) as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (MOA, July 4, 2025) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. OIRA has determined that the proposed rulemaking is a significant regulatory action and subject to review under section 3(f) of Executive Order 12866 and section 1(b) of the Memorandum of Agreement. Accordingly, the proposed regulations have been reviewed by OMB.

A. Background

Section 987 applies when a taxpayer owns a qualified business unit, or QBU, that has a functional currency different from the taxpayer's functional currency. In general, section 987(1) and (2) provide rules for determining and translating the QBU's taxable income or loss, while section 987(3) requires proper adjustments for transfers of property between QBUs with different functional currencies. In practical terms, section 987(3) generally requires the owner of a section 987 QBU to recognize foreign currency gain or loss when the QBU makes a remittance to its owner or is terminated.

The Treasury Department and the IRS have issued several sets of regulations and proposed regulations under section 987. In 1991, Treasury and the IRS issued proposed regulations that provided an earnings and capital method for determining section 987 gain or loss. Under that approach, taxpayers maintained an equity pool in the QBU's functional currency and a basis pool in the owner's functional currency; the equity pool generally represented the QBU's branch equity, and the basis pool generally represented the owner's basis in that branch equity. The pools were adjusted for the QBU's taxable income or loss and for contributions and remittances. During the years following the 1991 proposed regulations, many taxpayers became familiar with this framework.

In 2006, Treasury and the IRS issued new proposed regulations and withdrew the 1991 proposed regulations. The new proposed regulations were later finalized with modifications in 2016. Unlike the 1991 pool-based approach, the 2016 final regulations adopted a more detailed balance-sheet-based framework that required the recognition of currency gain or loss only on financial assets and liabilities, referred to as "marked items," and not other assets and liabilities, referred to as "historic items." In general, that framework required taxpayers to determine the items of income, gain, deduction, and loss attributable to a section 987 QBU in the QBU's functional currency and translate those items into the owner's functional currency, with the marked items referencing a spot exchange rate and the historic items referencing the historic exchange rate at which the item was acquired or incurred. The rules also required taxpayers to compute and maintain net unrecognized section 987 gain or loss with respect to each section 987 QBU, based on changes in the QBU's balance sheet, and to recognize a portion of that accumulated currency gain or loss when the QBU made a remittance to its owner. However, the applicability date of the 2016 final regulations was deferred several times, and taxpayers continued to face uncertainty about how to apply section 987 to their QBUs.

In December 2024, Treasury and the IRS finalized regulations under section 987 that retained the balance-sheet-based framework of the 2016 final regulations, with modifications intended to improve administrability, including an election (the current rate election) to recognize currency gain or loss with respect to all of a QBU's assets and liabilities, which eliminates the need to track historic exchange rates for historic items. The 2024 final regulations generally apply to taxable years beginning after December 31, 2024, and apply to

CFCs that own section 987 QBUs. Under those rules, a CFC generally must determine section 987 taxable income or loss with respect to a section 987 QBU, compute net unrecognized section 987 gain or loss, and recognize section 987 gain or loss when the QBU makes a remittance or in connection with certain terminations. The 2024 final regulations also provide elections and related rules, including the current rate election, an annual recognition election, loss suspension rules, and transition rules for preexisting section 987 gain or loss.

At the same time, Treasury and the IRS issued 2024 proposed regulations addressing frequently recurring disregarded transactions between a section 987 QBU and its owner. Those proposed regulations also requested comments on the application of section 987 to partnerships and CFCs. In particular, Treasury and the IRS requested comments on whether section 987(3) and the related regulations should apply to CFCs, noting both the potential compliance burden of applying section 987(3) to section 987 QBUs of CFCs and the need to address concerns about excess asset basis in inbound transactions if section 987(3) were not applied to section 987 QBUs of CFCs.

In February 2026, Treasury and the IRS issued Notice 2026-17. The Notice announced forthcoming proposed regulations intended to simplify the operation of the 2024 final regulations, reduce compliance burdens, and limit the effect of certain section 987 rules on ordinary course transactions. In particular, the Notice described an election to use an equity and basis pool method for determining section 987 taxable income or loss and section 987 gain or loss, in lieu of certain balance-sheet-based computations under the 2024 final regulations. Under that method, taxpayers would generally maintain an equity pool in the section 987 QBU's functional currency and a basis pool in the owner's functional currency, with those pools adjusted for QBU income or loss and transfers between the QBU and its owner. In addition, the Notice announced that forthcoming proposed regulations would provide an election under which CFCs generally would not compute or recognize section 987 gain or loss under section 987(3), except in connection with certain inbound nonrecognition transactions.

The proposed regulations in this NPRM implement that CFC exemption election. Under the proposed regulations, taxpayers may elect to not apply section 987(3) and the related regulations generally to CFCs covered by the election (except to the extent provided in the proposed regulations). Section 987(1) and (2) would continue to apply, so CFCs would still determine and translate section 987 taxable income or loss as necessary for Federal income tax purposes. The proposed regulations also provide rules for making and revoking the election, consistency requirements for commonly controlled CFCs, treatment of pre-election section 987 gain or loss, and special rules for inbound nonrecognition transactions. The inbound nonrecognition transaction rules are intended to prevent exchange-rate-driven asset basis increases from being imported into the United States without appropriate recognition of section 987 gain. The other parts of Notice 2026-17 regarding the simplification of the 2024 final regulations will be addressed in other forthcoming proposed regulations.

B. Need for proposed regulations

Proposed regulations are needed to provide taxpayers with operative rules for making and applying the CFC exemption election, in order to reduce the compliance and administrative burdens of applying section 987(3) with respect to section 987 QBUs owned by CFCs. Notice 2026-17 announced that Treasury and the IRS intended to issue rules allowing CFCs generally not to compute or recognize section 987 gain or loss under section 987(3), except in connection with certain inbound nonrecognition transactions, but the Notice functioned as a preview of future guidance rather than a complete set of rules taxpayers could rely on to make the election.

Sections 987 and 989 provide regulatory authority for these rules. Section 987(3) directs the Secretary to prescribe the proper adjustments needed for transfers between QBUs with different functional currencies, and section 989(c) authorizes regulations necessary or appropriate to carry out the purposes of the foreign currency rules, including rules for related-party and QBU transactions.

Absent proposed regulations, taxpayers would not have the specific rules needed to implement the CFC exemption election on tax returns. Taxpayers need guidance on which CFCs are covered, who makes the election, when and how the election is made, whether the election must be applied consistently across commonly controlled CFCs, how pre-election section 987 gain or loss is treated, and what happens in inbound nonrecognition transactions or revocations of the election.

C. The proposed regulations

The proposed regulations provide an election, referred to as the CFC exemption election, under which an electing CFC generally would not compute or recognize section 987 gain or loss with respect to its section 987 QBUs, i.e., branches or disregarded entities with functional currencies different from the CFC's functional currency. The election is intended to reduce the compliance and administrative burdens associated with applying the 2024 final regulations to CFCs that own section 987 QBUs.

The proposed regulations do not exempt CFCs from section 987 entirely. Section 987(1) and (2) would continue to apply for purposes of determining and translating section 987 taxable income or loss, including for purposes of computing taxable income and earnings and profits. Thus, the election is targeted at section 987(3) gain or loss recognition, rather than the broader rules for determining QBU income. For example, in taxable years in which the CFC exemption election is in effect, a CFC would continue to translate section 987 taxable income or loss under the applicable section 987 rules, generally using the yearly average exchange rate and by deeming a current rate election to be in effect. But if property is transferred from a section 987 QBU to the CFC owner in a transaction that would be treated as a remittance, the CFC generally would not compute or recognize section 987 gain or loss under section 987(3) as a result of that transfer.

The proposed regulations provide rules for making and revoking the CFC exemption election. In general, the election would be made by the authorized person for the relevant section 987 electing group. Special timing rules would apply for early years to allow taxpayers sufficient time to evaluate the election after issuance of the proposed and final regulations. The proposed regulations also provide that the election generally could not be revoked without the consent of the Commissioner. These rules are intended to make the election administrable and to reduce uncertainty for taxpayers preparing returns for the first years in which the 2024 final regulations apply.

The proposed regulations also include consistency requirements. The CFC exemption election generally must be made consistently for commonly controlled CFCs, including majority-owned CFCs of affiliated domestic corporations. The proposed regulations also include rules addressing CFC stock owned through domestic partnerships and an anti-avoidance rule for related-party transactions designed to avoid the consistency requirements or trigger an inappropriate deemed revocation. These rules are intended to prevent taxpayers from selectively applying the election to CFCs with expected section 987 gains while leaving other CFCs with expected section 987 losses outside the election.

The proposed regulations address section 987 gain or loss that arose before the CFC exemption election became effective. In general, an exempt CFC would compute its pre-election section 987 gain or loss and recognize that amount ratably over a 120-month period beginning with the first month of the taxable year for which the CFC exemption election is made. This rule preserves the tax consequences of section 987 gain or loss that accrued before the election by requiring both pre-election gain and pre-election loss to be taken into account over the same 120-month period. The proposed regulations would provide a mandatory asset basis test for certain smaller section 987 QBUs. Under this test, a QBU with assets of less than $50 million would not be required to compute or recognize pre-election unrecognized section 987 gain or loss in connection with the CFC exemption election. The $50 million threshold would be applied separately to each QBU (or to each group of same-country QBUs), based on the QBU's average assets for the three-year period preceding the first taxable year for which the election is made. This rule is intended to reduce transition-related compliance burdens for smaller QBUs for which the cost of computing pre-election section 987 pools may be relatively high compared to the potential tax amounts at issue.

The proposed regulations also provide rules for partnerships owned by exempt CFCs. If an exempt CFC owns a section 987 QBU through a partnership, or if a partnership is sufficiently owned by exempt CFCs, the proposed regulations generally would extend the CFC exemption election to the relevant QBU as if the QBU were owned directly by an exempt CFC. These rules are intended to provide similar treatment for section 987 QBUs owned directly by exempt CFCs and section 987 QBUs owned through partnerships by exempt CFCs, while continuing to require reasonable and consistent application of section 987(1), section 987(2), and section 989(a).

Finally, the proposed regulations include an important limitation on the election for certain inbound nonrecognition transactions. If an exempt CFC engages in an inbound liquidation or reorganization, the proposed regulations would require the CFC to recognize section 987 gain to the extent exchange-rate fluctuations have increased the basis of assets transferred to a domestic corporation in the transaction. This rule is intended to prevent unrecognized currency gain from increasing the basis of assets transferred to a domestic corporation without a corresponding income inclusion. For this purpose, the proposed regulations would provide two proxy methods for computing the amount of section 987 asset basis, giving taxpayers flexibility to use the method that is more administrable in their circumstances. The first method is based on net unrecognized section 987 gain over a specified historical period, and the second one is based on excess asset basis concepts under section 367(b). The proposed regulations would not provide a corresponding rule allowing an exempt CFC to recognize section 987 loss in an inbound transaction.[4] This limitation is intended to prevent taxpayers from using elective inbound transactions to selectively recognize losses, and is consistent with the longstanding treatment of inbound nonrecognition transactions under section 367(b), which does not permit the recognition of a deduction or loss. A de minimis rule would exclude certain smaller inbound transactions from the requirement to compute and recognize section 987 asset basis.

D. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the proposed regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations.

E. Economic effects of the proposed regulations

1. Affected taxpayers

The proposed regulations would affect U.S. taxpayers that own CFCs with section 987 QBUs. Based on 2023 filing-year data from the IRS Research, Applied Analytics, and Statistics Division, the Treasury Department and the IRS estimate that approximately 1,500 taxpayers would be affected by the proposed regulations. This estimate is based on the number of entities that own at least one CFC with a section 987 QBU.

The taxpayers most directly affected are multinational groups with CFCs that conduct foreign branch operations in currencies different from the functional currency of the CFC owner. These taxpayers may otherwise be required under the 2024 final regulations to compute and track section 987 gain or loss, remittances, transition amounts, and related attributes for their CFC-owned section 987 QBUs. Taxpayers that do not own CFCs with section 987 QBUs, or that do not make the CFC exemption election, generally would not be materially affected by the election rules.

[4] This approach is consistent with the 2024 final regulations' treatment of suspended section 987 losses in inbound nonrecognition transactions, under which suspended losses generally are not imported into the United States and may be recognized only under the applicable loss-to-the-extent-of-gain rules.

2. Reduction in compliance and administrative burden from the CFC exemption election

The principal economic effect of the proposed regulations is expected to be a reduction in recurring compliance and administrative burden for taxpayers that make the CFC exemption election. Under the baseline, CFCs generally must compute net unrecognized section 987 gain or loss and recognize section 987 gain or loss on remittances or certain terminations. These computations can require detailed information about section 987 QBU assets and liabilities, transfers between a QBU and its owner, exchange rates, remittances, suspended losses, deferred amounts, and transition items. By contrast, once the CFC exemption election applies, an electing CFC generally would not compute or recognize section 987 gain or loss under section 987(3) for ordinary CFC branch operations.

Public comments on prior section 987 regulations indicate that these computations can impose meaningful taxpayer-specific burdens. One commenter, a public company with approximately 10 to 15 QBUs using a functional currency different from their owner, stated that its historical section 987 monitoring and calculation burden had been approximately 20 hours or less per year, but that the 2016 section 987 regulations would require substantially more work.[5] The commenter estimated at least 80 hours merely to obtain a working knowledge of the rules, elections, and calculations, and at least 80 hours for a single QBU to transition to the Foreign Exchange Exposure Pool (FEEP) method in one example involving historic asset and exchange-rate tracking. The same commenter stated that annual calculations and disclosures would be needed for each QBU and would require weeks of work.

By allowing CFCs covered by the election generally not to compute or recognize section 987 gain or loss under section 987(3), the proposed regulations would reduce the need for ongoing section 987(3) computations for ordinary CFC branch operations. Taxpayers would still need to apply section 987(1) and (2) to determine and translate section 987 taxable income or loss, and certain computations would remain necessary for pre-election gain or loss and inbound nonrecognition transactions.[6] However, for electing taxpayers, the proposed regulations are expected to reduce recurring compliance costs and reduce the administrative burden on the IRS associated with reviewing routine CFC remittance computations.

The exact magnitude of these compliance cost savings is uncertain. Although the compliance burden reduction may encourage some taxpayers to make the CFC exemption election, it is possible not all eligible taxpayers will do so.[7] Further, available tax return data do not directly measure the number of hours taxpayers spend applying section 987(3) to each affected QBU, nor the exact cost associated with those hours worked. Treasury and the IRS therefore consider a range of estimates using three inputs: the number of affected section 987 QBUs, the hours saved per affected QBU, and the hourly labor cost of the tax professionals performing the work.

As noted above, it is estimated that approximately 1,500 entities own at least one CFC with a section 987 QBU. For a lower bound on the number of affected QBUs, it is assumed that two-thirds of the entities make the CFC exemption election, and that each entity owns only one CFC with one section 987 QBU, yielding 1,000 affected QBUs. However, many of these entities in fact own multiple CFCs with section 987 QBUs, and their compliance costs are therefore higher, as they must be incurred for each section 987 QBU. For an upper bound on the number of affected QBUs, it is assumed that all of the entities make the election, and that each owns three QBUs on average, yielding 4,500 affected QBUs.

For the number of hours saved per affected QBUs, Treasury and the IRS consider the compliance activities avoided and the public comment described above. These imply that the proposed regulations may reduce recurring compliance work by approximately 20-60 hours per affected QBU per year. The lower end reflects a conservative recurring burden estimate; the higher end reflects the greater complexity of applying the section 987 regulations to taxpayers with multiple currencies, multiple CFCs, frequent disregarded transactions, remittances, or more complex branch balance sheets. The hourly cost of this work is estimated using a monetization rate of $88.50 per hour, which IRS Research, Applied Analytics, and Statistics applies for certain information collection burdens specifically related to tax filing.

Using a central estimate of 4,500 affected QBUs, 40 hours saved per QBU, and $88.50 per hour of tax professional work, the Treasury and the IRS estimate that the proposed regulations would generate approximately $16 million in annual compliance cost savings.

Table 1: Estimated annual compliance savings

Affected QBUs	Hours saved per QBU	Cost per hour	Estimated annual compliance savings (millions)
1,000	20	$88.50	$1.8
4,500	40	$88.50	$15.9
4,500	60	$88.50	$23.9

[5] Alternative methodologies introduced in subsequent guidance are likely to entail lower compliance costs relative to the 2016 section 987 regulations.

[6] The proposed regulations include a mandatory asset-based test that would exempt taxpayers from calculating pre-election gain or loss pool for QBUs with less than $50 million in assets.

[7] Some taxpayers may decline to make the CFC exemption election. One reason may be that the CFC exemption election would apply consistently across commonly controlled CFCs and could be revoked only with the consent of the Commissioner. These limitations may reduce the value of the CFC exemption election for taxpayers that expect their structures, currency exposures, or planning needs to change in the future and therefore prefer flexibility across CFCs, QBUs, or taxable years. Another reason may be that the election does not eliminate all section 987-related compliance obligations: section 987(1) and (2) would continue to apply, and special rules would require recognition of section 987 gain in certain inbound nonrecognition transactions to prevent excess asset basis attributable to exchange-rate fluctuations from escaping U.S. tax.

This estimate should be interpreted as an order-of-magnitude estimate rather than a precise measurement. The actual savings will depend on the number of CFCs and QBUs for which taxpayers make the election, the extent of existing section 987 compliance systems, the number and complexity of currencies and disregarded transactions, the frequency of remittances and restructurings, and the amount of residual work required for pre-election section 987 gain or loss and inbound transactions.

3. Effects of pre-election gain or loss amortization and the QBU-level asset-based test

The proposed regulations would require pre-election section 987 gain or loss to be recognized ratably over a 120-month period. This rule applies to taxpayers that make the CFC exemption election after unrecognized section 987 gain or loss has already accrued. It is intended to preserve the tax consequences of currency gain or loss that arose before the election became effective and to prevent asymmetric results under which taxpayers with accrued gains could elect out of section 987(3) and eliminate those gains, while taxpayers with accrued losses could preserve or accelerate those losses.

The 120-month period also smooths the transition into the CFC exemption election. Relative to immediate recognition, ratable recognition reduces the likelihood that making the election would produce a large one-year tax effect for taxpayers with substantial pre-election section 987 gain. Similarly, taxpayers with substantial pre-election section 987 loss would not receive an immediate deduction for the full amount. This treatment reduces the extent to which the election itself creates a timing benefit or cost unrelated to current business operations.

Using months rather than taxable years also avoids acceleration in short taxable years. For a taxpayer with full 12-month taxable years, a 120-month period generally produces the same annual recognition pattern as a 10-year period. For a taxpayer with a one-month short taxable year, however, the monthly rule would require recognition of 1/120th of the relevant amount rather than one-tenth. This reduces the extent to which the occurrence or timing of a short taxable year affects the tax consequences of entering the election.

The proposed regulations would also include a mandatory QBU-level asset-based test intended to reduce transition burden for smaller QBUs. Under this test, a QBU with average assets of less than $50 million for the three-year period preceding the election would not be required to compute or recognize pre-election unrecognized section 987 gain or loss in connection with the CFC exemption election. Because reconstructing historical or pretransition section 987 pools may involve fixed costs per QBU, the test is expected to reduce entry costs for smaller QBUs for which those fixed costs may be large relative to the expected future compliance savings from the election.

Based on Form 8858 returns for tax year 2021, the Treasury Department and the IRS estimate that a $50 million threshold would exempt about 75 percent of section 987 QBUs from calculating pre-election pools, while excluding less than 5 percent of reported QBU assets. Thus, the test would provide broad compliance relief by QBU count while retaining the transition rules for larger QBUs, where the potential tax consequences are more likely to be material.

For QBUs above the asset threshold, taxpayers making the election would need to compute pre-election section 987 gain or loss and track the recognized and remaining unrecognized amounts over the 120-month period.[8] These costs are likely to be greatest for taxpayers that make the CFC exemption election after the transition date, taxpayers with multiple CFC-owned section 987 QBUs, taxpayers with outstanding deferred section 987 gain or loss or cumulative suspended section 987 loss, and taxpayers that own section 987 QBUs through partnerships. These costs are transitional and targeted; they are linked to preserving pre-election amounts while the CFC exemption election generally reduces ongoing section 987(3) computations for ordinary CFC branch operations after the election takes effect.

Overall, the 120-month amortization rule and the QBU-level asset-based test are expected to make the CFC exemption election more administrable while limiting selective tax effects from accrued section 987 positions. The amortization rule preserves pre-election amounts and reduces incentives to time the election to eliminate gains or accelerate losses. The asset-based test reduces the principal transition cost for smaller QBUs—the need to compute historical or pre-election section 987 pools—while retaining the transition rules for QBUs for which the potential tax consequences are more likely to be material.

4. Effects of the inbound transaction rules

The proposed regulations include special rules for certain inbound nonrecognition transactions involving exempt CFCs. These rules are intended to prevent exchange-rate-driven increases in asset basis from being imported into the United States without corresponding gain recognition. Without these rules, a CFC exemption election could reduce the compliance burden for ordinary CFC branch operations but also create an opportunity for untaxed section 987 currency gain to be reflected in the basis of assets transferred to a domestic corporation in an inbound liquidation or reorganization. That imported basis could then reduce U.S. taxable income through depreciation, amortization, gain reduction, or loss recognition in later years.

The economic effect of these rules is expected to be targeted. The rules apply only when assets of an exempt CFC are acquired in an inbound nonrecognition transaction, rather than to ordinary-course remittances or ongoing CFC branch operations. In addition, the gain-recognition rule generally approximates the treatment that would apply if the CFC exemption election were not in effect, because the 2024 final regulations generally treat section 987 QBUs owned

[8] The Treasury Department and the IRS expect most taxpayers transitioning to the 2024 final regulations generally will have incurred those same costs for all of their QBUs in deciding whether to make the 10-year amortization election under the 2024 final regulations. Therefore, the CFC exemption election is unlikely to create a new burden for these taxpayers.

by a CFC as terminated immediately before an inbound nonrecognition transaction and require recognition of any net unrecognized section 987 gain at that time. Thus, relative to the baseline, the inbound transaction rules principally prevent the CFC exemption election from changing the treatment of a targeted class of restructuring transactions in a way that could allow excess asset basis to enter the U.S. tax system.

The proposed regulations would require recognition of section 987 gain based on two alternative methods for determining section 987 asset basis. These methods are intended to serve as administrable proxies that reduce the need for full historical section 987 computations while preserving gain recognition in transactions where the basis-importation concern is most significant. The first methodology would generally use a six-year lookback computation of net unrecognized section 987 gain, while the second methodology would use excess asset basis concepts under section 367(b). These alternatives may reduce compliance costs by allowing taxpayers to use the method that is more administrable in their circumstances, although either method may be imprecise for some taxpayers. The proposed regulations also include a de minimis rule, which reduces compliance burden for smaller inbound transactions of CFCs with less than $25 million in assets, where any potential basis-importation concern is less likely to be economically significant.

Consistent with the 2024 final regulations' treatment of suspended section 987 losses in inbound nonrecognition transactions, the proposed regulations would not provide a special rule allowing an exempt CFC to recognize section 987 loss in an inbound transaction. This asymmetric treatment may deny loss recognition in some cases, but it reduces the risk that taxpayers could selectively enter into elective inbound transactions to trigger foreign currency losses. This approach is also consistent with the longstanding treatment of inbound nonrecognition transactions under section 367(b), which does not permit the recognition of a deduction or loss.

For these reasons, the inbound transaction rules are expected to have limited effects on ordinary business operations and investment decisions, while reducing opportunities for tax-motivated basis importation in a narrow class of transactions.

5. Effects of consistency and anti-avoidance requirements

The proposed regulations require the CFC exemption election to be made consistently for commonly controlled CFCs and include anti-avoidance rules for related-party transactions designed to avoid those consistency requirements or produce inappropriate deemed revocations. These rules are intended to reduce selective use of the election. In particular, they limit the ability of a taxpayer group to apply the CFC exemption election selectively for tax-motivated reasons. This helps ensure that the election functions as a simplification rule, rather than as a tool for one-sided gain avoidance or loss preservation.

The consistency requirements may reduce flexibility for taxpayers with CFCs that have different section 987 profiles. A taxpayer may have some CFCs with expected section 987 gains and others with expected section 987 losses, or some CFCs with relatively simple branch operations and others with more complex currency exposures. A consistent election rule may therefore cause some taxpayers to forgo the election, especially if the taxpayer values flexibility to recognize losses under the baseline rules or is uncertain about future currency movements, acquisitions, dispositions, or restructurings. The constraint is targeted, however: taxpayers remain able to choose whether to make the election, and the rules primarily limit selective use of the election within commonly controlled groups, where the potential for tax-motivated sorting is greatest.

Absent consistency requirements, taxpayers would have stronger incentives to organize CFC ownership and branch structures around expected section 987 outcomes. A taxpayer could elect exempt treatment for CFCs with built-in or expected section 987 gains while declining the election for CFCs with built-in or expected section 987 losses, producing one-sided results across CFCs that are economically part of the same multinational group. The rules also reduce incentives to alter ownership chains, branch structures, or related-party transactions to separate gain-producing and loss-producing section 987 QBUs into different election groups. By requiring the taxpayer to evaluate the election across its commonly controlled CFC structure, the rules reduce the extent to which tax outcomes depend on formal ownership structure rather than underlying economic activity.

The anti-avoidance rules reinforce the consistency requirements by addressing controlled-group transactions undertaken with a principal purpose of avoiding the requirement to make the CFC exemption election, causing an inappropriate deemed revocation, or causing a partnership to cease to be an exempt partnership. These rules reduce the value of related-party restructuring designed to change election status without a corresponding change in the group's economic position. As a result, they are expected to preserve the compliance-cost reduction objective of the election while limiting the use of related-party transactions to obtain one-sided section 987 outcomes.

Overall, the consistency and anti-avoidance requirements are expected to improve the integrity and administrability of the CFC exemption election. Although they may reduce election uptake at the margin, they also reduce opportunities for selective gain avoidance and loss recognition, limit incentives for tax-motivated restructuring, and promote more consistent treatment among taxpayer groups with similar CFC branch operations and common control relationships.

6. Summary

Overall, the proposed regulations are expected to be taxpayer-favorable and burden-reducing relative to the 2024 final regulations. The principal economic effects are expected to be reduced annual compliance costs of approximately $16 million, greater certainty for return preparation, reduced administrative burden, and targeted protection against basis importation in inbound nonrecognition transactions. The Treasury Department and the IRS invite public comments and additional data on the economic effects that would result from these proposed regulations.

II. *Paperwork Reduction Act*

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) (PRA) requires that a Federal agency obtain the approval of the Office of Management and Budget (OMB) before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the OMB.

The collection of information in the proposed regulations is in proposed § 1.987-1(g)(3). The likely respondents are U.S. shareholders of CFCs that own section 987 QBUs.

The collection of information in proposed § 1.987-1(g)(3) is required only when a taxpayer makes or revokes a CFC exemption election under proposed § 1.987-15. In general, taxpayers can make a CFC exemption election without the Commissioner's consent, but consent is required to revoke the election. The Commissioner's consent may be granted with a private letter ruling. When a taxpayer makes or revokes a CFC exemption election, the collection of information is mandatory. The collection of information required by proposed § 1.987-1(g)(3) will be used by the IRS for tax compliance purposes.

The Treasury Department and the IRS intend that the information described in proposed § 1.987-1(g)(3) will be collected by attaching a statement to Form 8964-ELE. For purposes of the PRA, the reporting burden associated with those collections of information will be reflected in the PRA submissions associated with Form 8964-ELE. The OMB Control Number for Form 8964-ELE will be included within 1545-0123 for business filers, 1545-0074 for individual filers, and 1545-0092 for trust and estate filers in accordance with the PRA procedures under 5 CFR 1320.10.

To the extent that a taxpayer makes or revokes an election by obtaining a private letter ruling, the reporting burden associated with those collections of information will be reflected in the PRA submissions associated with revenue procedures governing private letter rulings. The OMB Control Number for those revenue procedures is control number 1545-1522. The proposed regulations would require taxpayers merely to follow the procedures under Revenue Procedure 2026-1, IRB 2026-1 (or future revenue procedures governing private letter rulings) and would not change the collection requirements of the Revenue Procedure.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

III. *Regulatory Flexibility Act*

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act.

The proposed regulations affect U.S. shareholders of CFCs with foreign branch operations. The number of small entities potentially affected by the proposed regulations is unknown; however, it is unlikely to be a substantial number because taxpayers that are U.S. shareholders of CFCs are typically larger businesses. The Treasury Department and the IRS estimate that the total number of entities that own a CFC with a foreign branch subject to section 987 is approximately 1,500 (many of which may not make the CFC exemption election). This estimate is based on the number of corporations and partnerships that filed a Form 8858 in 2023 that showed that the filer: (1) owned at least one disregarded entity or branch with a functional currency different from the functional currency of the owner, (2) indicated that the disregarded entity or branch was a section 989 QBU, and (3) indicated that the disregarded entity or branch was owned by a CFC. As shown in the following table, only a small percentage of those filers are small entities.

Total Receipts/Positive Income (2023)	Percentage of Filers
Under $10 Million	12%
$10 Million to $25 Million	5%
$25 Million to $50 Million	4%
Over $50 Million	79%

A portion of the economic impact of the proposed regulations may derive from the collection of information requirements imposed under proposed § 1.987-1(g)(3). The Treasury Department and the IRS have determined that the average burden is 1.95 hours per response. The IRS's Research, Applied Analytics, and Statistics division estimates that the appropriate wage rate for this set of taxpayers is $88.50 per hour. Thus, the annual burden per taxpayer from each collection of information requirement is $172.60.

IV. *Section 7805(f)*

Pursuant to section 7805(f) of the Code, this proposed regulation will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

V. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. The proposed regulations do not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

VI. *Executive Order 13132: Federalism*

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. The proposed regulations do not have federalism implications and do not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this document are published in the Internal Revenue Bulletin or Cumulative Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *https://www.irs.gov*.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all other aspects of the proposed regulations. Any comments submitted will be made available at *https://www.regulations.gov* or upon request. Pursuant to the Administrative Procedure Act at 5 U.S.C. 553(b)(4), a plain language summary of the proposed rule is also available at *https://www.regulations.gov*.

A public hearing concerning the proposed regulations will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these proposed regulations are Raphael J. Cohen and Mark T. Terrell of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Adoption of Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Par. 2. Section 1.367(b)-3 is amended by:

1. Revising the introductory text of paragraph (g)(2)(i); and
2. Adding a sentence to the end of paragraph (g)(7)(i).

The revisions and addition read as follows:

§ 1.367(b)-3 Repatriation of foreign corporate assets in certain nonrecognition transactions.

* * * * *

(g) * * *

(2) * * *

(i) *Excess asset basis*. The term *excess asset basis* means, with respect to a foreign acquired corporation, the amount (determined after the application of § 1.987-16(d)) by which the inside asset basis of that corporation exceeds the sum of the following amounts:

* * * * *

(7) * * *

(i) * * * Paragraph (g)(2)(i) of this section, to the extent it relates to the application of § 1.987-16(d), applies to transactions completed within taxable years of the domestic acquiring corporation ending on or after [date of filing of final regulations with the **Federal Register**].

* * * * *

Par. 3. Section 1.987-1 is amended by:

1. In paragraph (a):
   a. In the first sentence, removing the language "1.987-15" and adding the language "1.987-17" in its place;
   b. Revising the current last sentence of the paragraph and adding two sentences to the end of the paragraph;
2. In paragraph (g):
   a. Adding paragraphs (g)(2)(iv) and (v);
   b. Revising the first sentence of paragraph (g)(3)(ii)(A); and
   c. Adding paragraph (g)(3)(ii)(D).
3. In paragraph (h), adding definitions for "CFC exemption election", "Domestic acquiring corporation," "Exempt CFC", "Exempt partnership", "Exempt partnership QBU", "Inbound nonrecognition transaction", "Pre-election section 987 gain or loss", "Pre-transaction period", "Pre-transaction taxable year," and "transferor CFC" in alphabetical order.

The revisions and additions read as follows:

§ 1.987-1 Scope, definitions, and special rules.

(a) * * * Section 1.987-15 provides rules relating to the CFC exemption election. Section 1.987-16 provides rules that apply to an inbound liquidation or reorganization of a CFC that was subject to the CFC exemption election. Section 1.987-17 provides the applicability date of the section 987 regulations.

* * * * *

(g) * * *

(2) * * *

(iv) *Commissioner consent*. An election is not deemed to be made or revoked under this paragraph (g)(2) or § 1.987-15(c) if the authorized person requests and receives consent from the Commissioner (as described in paragraph (g)(3)(ii)(A) of this section) to not make or to not revoke the election, as applicable.

(v) *CFC exemption election. See* § 1.987-15(c) for additional rules that apply with respect to the CFC exemption election.

(3) * * *

(ii) * * *

(A) * * * Except as provided in paragraph (g)(3)(ii)(B), (C), or (D) of this section, a section 987 election may not be made or revoked without the consent of the Commissioner. * * *

* * * * *

(D) *CFC exemption election*—(*1*) *Taxable years beginning after December 31, 2024 and ending on or before December 31, 2026*. For a taxable year beginning after December 31, 2024, and ending on or before December 31, 2026, the authorized person may make a CFC exemption election without the Commissioner's consent by attaching the election statement described in paragraph (g)(3)(i) of this section to its original, timely filed (including extensions) return for such taxable year, in accordance with the prescribed form or its instructions (or other guidance). In addition, for a taxable year beginning in 2025, the authorized person may make a CFC exemption election without the Commissioner's consent by attaching the election statement described in paragraph (g)(3)(i) of this section to an amended return for such taxable year filed on or before October 15, 2027, in accordance with the prescribed form or its instructions (or other guidance).

(*2*) *Taxable years ending in 2027*. For a taxable year ending in 2027 (other than a taxable year to which paragraph (g)(3)(ii)(D)(*4*) of this section applies), the authorized person may make a CFC exemption election without the Commissioner's consent by filing the statement described in paragraph (g)(3)(i) of this section with the Internal Revenue Service in accordance with the prescribed form or its instructions (or other guidance) on or before October 15, 2027, and attaching a copy of the statement to its return for such taxable year.

(*3*) *Taxable years ending after December 31, 2027*. For a taxable year ending after December 31, 2027 (other than a taxable year to which paragraph (g)(3)(ii)(D)(*4*) of this section applies), the authorized person may make a CFC exemption election without the Commissioner's consent by filing the statement described in paragraph (g)(3)(i) of this section with the Internal Revenue Service in accordance with the prescribed form or its instructions (or other guidance) on or before the first day of the taxable year to which the election applies, and attaching a copy of the statement to its return for such taxable year.

(*4*) *Taxable year in which election first becomes relevant*. For the taxable year in which the CFC exemption election first becomes relevant, the authorized person may make a CFC exemption election without the Commissioner's consent by attaching the election statement described in paragraph (g)(3)(i) of this section to its original, timely filed (including extensions) return for such taxable year, in accordance with the prescribed form or its instructions (or other guidance). For this purpose, the CFC exemption election first becomes relevant with respect to an authorized person in the first taxable year of the authorized person beginning after December 31, 2024, in which a CFC that is the owner of a section 987 QBU is part of the authorized person's section 987 electing group.

* * * * *

(h) * * *

* * * * *

CFC exemption election. *CFC exemption election* has the meaning provided in § 1.987-15(a).

* * * * *

Domestic acquiring corporation. *Domestic acquiring corporation* has the meaning provided in § 1.987-16(b).

* * * * *

Exempt CFC. *Exempt CFC* has the meaning provided in § 1.987-15(a).

Exempt partnership. *Exempt partnership* has the meaning provided in § 1.987-7(b)(2)(iv).

Exempt partnership QBU. *Exempt partnership QBU* has the meaning provided in § 1.987-7(b)(2)(iii).

* * * * *

Inbound nonrecognition transaction. *Inbound nonrecognition transaction* has the meaning provided in § 1.987-16(b).

* * * * *

Pre-election section 987 gain or loss. *Pre-election section 987 gain or loss* has the meaning provided in § 1.987-15(e)(2).

Pre-transaction period. *Pre-transaction period* has the meaning provided in § 1.987-16(b)(2).

Pre-transaction taxable year. *Pre-transaction taxable year* has the meaning provided in § 1.987-16(c)(2)(ii).

* * * * *

Transferor CFC. *Transferor CFC* has the meaning provided in § 1.987-16(b).

* * * * *

Par. 4. Section 1.987-6 is amended by adding paragraphs (b)(1)(v) and (vi) to read as follows:

§ 1.987-6 Character and source of section 987 gain or loss.

* * * * *

(b) * * *

(1) * * *

(v) In the case of net unrecognized section 987 gain or loss that is recognized as pre-election section 987 gain or loss under § 1.987-15(e)(3), the taxable year immediately preceding the first taxable year in which the CFC exemption election applies.

(vi) The taxable year in which the amount of section 987 asset basis is recognized under § 1.987-16(d).

* * * * *

Par. 5. Section 1.987-7 is amended by:

1. Revising paragraph (b);
2. In paragraph (c)(2)(i), removing the language "1.987-15" and adding the language "1.987-17" in its place; and
3. Adding paragraphs (c)(2)(iv) and (d)(2)(iv).

The revisions and additions read as follows:

§ 1.987-7 Application of the section 987 regulations to partnerships and S corporations.

* * * * *

(b) *Section 987 regulations generally do not apply to partnerships*—(1) *In general.* Except as otherwise provided in this section, the section 987 regulations do not apply to a partnership, and the section 987 regulations do not apply to an eligible QBU if a partnership is the direct owner of the eligible QBU.

(2) *Application of section 987 and section 989(a)*. In general, a taxpayer must apply sections 987 and 989(a) to partnerships and eligible QBUs directly owned by partnerships in a reasonable manner. However, in the case of an exempt partnership QBU, section 987(3) applies only to the extent provided in §§ 1.987-15 and 1.987-16.

(i) *Consistency*. In applying sections 987 and 989(a) with respect to a partnership or an eligible QBU directly owned by a partnership, taxpayers must use the same method consistently from year to year with respect to a particular partnership or eligible QBU. In addition, all members of the same controlled group must apply the same method consistently with respect to a particular partnership or eligible QBU.

(ii) *Tiered partnerships*. For purposes of the section 987 regulations, a taxpayer that owns an interest in a partnership (*lower-tier partnership*) indirectly through one or more other partnerships is treated as a partner in the lower-tier partnership.

(iii) *Exempt partnership QBU*. For purposes of the section 987 regulations, an *exempt partnership QBU* is a partnership (or an interest in the partnership) or an eligible QBU directly owned by a partnership, if the taxpayer applies sections 987 and 989(a) using a method under which—

(A) The partnership, interest in the partnership, or eligible QBU is a section 987 QBU; and

(B) The owner of the section 987 QBU is either an exempt CFC or an exempt partnership.

(iv) *Exempt partnership*. For purposes of the section 987 regulations, an *exempt partnership* is a partnership in which at least 80 percent of the capital or profits interests are owned (directly or indirectly through other partnerships) by exempt CFCs that are members of the same controlled group on the last day of the partnership's taxable year.

(c) * * *

(2) * * *

(iv) *Rules relating to the CFC exemption election*—(A) *In general*. Sections 1.987-15 and 1.987-16 apply to an exempt partnership QBU.

(B) *Certain rules not applicable to exempt partnership QBUs*. Notwithstanding paragraphs (c)(2)(i) and (ii) of this section, §§ 1.987-6 and 1.987-11 through 1.987-13 do not apply to an exempt partnership QBU (except to the extent provided in §§ 1.987-15 and 1.987-16), and an annual recognition election does not apply to an exempt partnership QBU.

* * * * *

(d) * * *

(2) * * *

(iv) *Exempt partnership QBU*. Paragraph (d)(1)(ii) of this section does not apply to an exempt partnership QBU.

* * * * *

Par. 6. Section 1.987-10 is amended by:

1. In paragraph (c)(1), removing the language "1.987-15(a)(1)" and adding the language "1.987-17(a)(1)" in its place;
2. Revising paragraph (e)(5)(ii)(A) and the last sentence of paragraph (e)(5)(ii)(C); and
3. Adding paragraph (e)(5)(ii)(D).

The revisions and addition read as follows:

§ 1.987-10 Transition rules.

* * * * *

(e) * * *

(5) * * *

(ii) * * *

(A) *In general*. A taxpayer may elect to recognize pretransition gain or loss ratably over the transition period. If an election is made to recognize pretransition gain or loss ratably over the transition period, then paragraph (e)(5)(i) of this section does not apply, and each owner to which the election applies recognizes its pretransition gain or loss with respect to each section 987 QBU, original deferral QBU, and outbound loss QBU ratably over a period of 120 months beginning with the first month of the taxable year that begins on the transition date described in paragraph (c)(1) of this section. *See* § 1.987-1(g) for rules relating to section 987 elections (including consistency rules).

* * * * *

(C) * * * The pretransition gain or loss is recognized ratably over a period of 120 months beginning with the first month of the taxable year that begins on the transition date described in paragraph (c)(1) of this section.

(D) *Amounts previously recognized under ten-year amortization rule*. For purposes of this paragraph (e)(5)(ii), if an owner recognized a ratable portion of its pretransition gain or loss in one or more taxable years under § 1.987-10(e)(5)(ii)(A) or (C), as contained in 26 CFR in part 1 in effect on April 1, 2025, each such taxable year is deemed to contain twelve months. Thus, for example, if the first taxable year of an owner in which the section 987 regulations apply is a short taxable year lasting one month, and the owner recognized one tenth of its pretransition gain or loss in that taxable year under § 1.987-10(e)(5)(ii)(A) or (C), as contained in 26 CFR in part 1 in effect on April 1, 2025, the owner recognizes its remaining pretransition gain or loss ratably over 108 months beginning with the first month of the next taxable year.

* * * * *

Par. 7. Section 1.987-15 is redesignated as § 1.987-17 and new § 1.987-15 is added to read as follows:

§ 1.987-15 CFC exemption election.

(a) *Overview*. This section provides rules for an election (*CFC exemption election*) under which section 987(3) applies to a CFC only to the extent provided in this section and § 1.987-16. Paragraph (b) of this section provides rules regarding the effect of making a CFC exemption election. Paragraph (c) of this section provides consistency requirements for making the election. Paragraph (d) of this section provides rules for coordinating the CFC exemption election with the transition rules of § 1.987-10. Paragraph (e) of this section provides rules under which a CFC that is subject to the CFC exemption election (an *exempt CFC*) must account for pre-election section 987 gain or loss. Paragraph (f) of this section provides rules that apply if a CFC exemption election is revoked. Paragraph (g) of this section provides rules for applying this section with respect to a partnership. Paragraph (h) of this section provides examples that illustrate the application of the rules of this section.

(b) *Effect of CFC exemption election*—(1) *In general*. Except as otherwise provided in this section or § 1.987-16, section 987(3) does not apply to an exempt CFC. In addition, the rules of the section 987 regulations apply to an exempt CFC only to the extent provided in this section or § 1.987-16. *See* § 1.987-7(b)(2), (c)(2)(iv), and (d)(2)(iv) for rules relating to the effect of a CFC exemption election on partnerships and eligible QBUs directly owned by partnerships.

(2) *Applicable provisions*. The rules of this section, and the rules of the section 987 regulations listed in this paragraph (b)(2), apply to an exempt CFC, subject to the modifications described in paragraph (b)(3) of this section.

(i) Section 1.987-1 (scope, definitions, and special rules);

(ii) Section 1.987-2 (attribution of items to eligible QBUs and other rules);

(iii) Section 1.987-3 (determination of section 987 taxable income or loss);

(iv) Section 1.987-5(f) (determination of the owner's adjusted basis in transferred assets and the amount of transferred liabilities);

(v) Section 1.987-7 (rules relating to partnerships);

(vi) Section 1.987-8 (QBU terminations), subject to the modifications described in paragraph (b)(3)(ii) of this section;

(vii) Section 1.987-9 (recordkeeping requirements), subject to the modifications described in paragraph (b)(3)(iii) of this section;

(viii) Section 1.987-10 (transition rules), including the application (for purposes of § 1.987-10) of rules cross-referenced in § 1.987-10;

(ix) Section 1.987-16 (inbound nonrecognition transactions involving an exempt CFC); and

(x) Section 1.987-17 (applicability dates).

(3) *Modifications to applicable provisions*—(i) *Current rate election*. With respect to an exempt CFC, the rules described in paragraph (b)(2) of this section are applied as if a current rate election were in effect.

(ii) *QBU terminations*. An exempt CFC does not recognize section 987 gain or loss under § 1.987-8(e) when a section 987 QBU terminates.

(iii) *Recordkeeping requirements*. With respect to an exempt CFC, the recordkeeping requirements set forth in § 1.987-9(b)(2), (b)(4) through (12), and (b)(14) do not apply. A taxpayer must retain the records necessary to substantiate the determinations required under this section and § 1.987-16, including the records needed to support the chosen methodology for computing section 987 asset basis under § 1.987-16(c).

(iv) *Partnerships*. *See* § 1.987-7(c)(2) for the rules that apply to an exempt partnership QBU.

(c) *Consistency requirements*—(1) *In general*. The consistency rules of § 1.987-1(g)(2) apply with respect to a CFC exemption election, subject to the modifications described in paragraph (c)(2) of this section and the anti-avoidance rule provided in paragraph (c)(3) of this section.

(2) *Modifications*—(i) *Affiliates treated as a single United States person*. All domestic corporations that are affiliates described in § 1.904(i)-1(b) on the last day of the taxable year described in § 1.904(i)-1(c) are treated as a single United States person. Thus, in applying § 1.987-1(g)(2)(ii) for purposes of the CFC exemption election, all such domestic corporations are part of the same section 987 electing group.

(ii) *Ownership through domestic partnerships*. For purposes of determining whether a United States person (other than a partnership) owns stock of a CFC within the meaning of section 958(a), stock of a foreign corporation owned by a domestic partnership is treated in the same manner as stock of a foreign corporation owned by a foreign partnership.

(3) *Anti-avoidance rule*—(i) *In general*—(A) *No deemed revocation*. Notwithstanding the rules of § 1.987-1(g)(2), if a transaction involving two or more members of the same controlled group is entered into with a principal purpose of causing a deemed revocation of a CFC exemption election under § 1.987-1(g)(2) or otherwise causing a CFC exemption election to cease to be effective, the CFC exemption election is not deemed to be revoked and remains in effect.

(B) *Deemed election*. If a transaction involving two or more members of the same controlled group is entered into with a principal purpose of avoiding the requirement to make a CFC exemption election with respect to one or more CFCs under § 1.987-1(g)(2) and paragraph (c)(2) of this section, the CFC exemption election is deemed to be made with respect to those CFCs.

(C) *Exempt partnerships*. If a transaction involving two or more members of the same controlled group is entered into with a principal purpose of causing an exempt partnership to cease to be an exempt partnership, the CFC exemption election is deemed to be made with respect to any CFC that is a partner in the partnership and is a member of the controlled group.

(ii) *Subsequent application of the consistency rule*. If a CFC is subject to a deemed CFC exemption election under paragraph (c)(3)(i) of this section, the CFC exemption election is also deemed to be made with respect to the other members of the CFC's section 987 electing group.

(d) *Coordination with transition rules provided in § 1.987-10*—(1) *Deemed election to recognize pretransition gain or loss ratably over the transition period*—(i) *In general*. If a CFC exemption election is made for the taxable year beginning on the transition date described in § 1.987-10(c)(1), the election to recognize pretransition gain or loss ratably over the transition period under § 1.987-10(e)(5)(ii) is deemed to be made with respect to each CFC for which the CFC exemption election is made.

(ii) *Consistency rules*. Notwithstanding the rules of § 1.987-1(g)(2), the election described in § 1.987-10(e)(5)(ii) is not required to be made with respect to the members of an exempt CFC's section 987 electing group (other than exempt CFCs) solely by reason of a deemed election described in paragraph (d)(1)(i) of this section.

(2) *Pretransition gain or loss with respect to QBUs that hold assets of less than $50 million*. Notwithstanding the rules of § 1.987-10, if a CFC exemption election is made for the taxable year beginning on the transition date described in § 1.987-10(c)(1), an exempt CFC is treated as having no pretransition gain or loss with respect to any QBU described in paragraph (e)(2)(iii)(B) of this section.

(e) *Election made in a subsequent taxable year*—(1) *In general*. This paragraph (e) provides rules under which an exempt CFC must compute and recognize pre-election section 987 gain or loss if the CFC exemption election is made for a taxable year other than the taxable year beginning on the transition date described in § 1.987-10(c)(1) (or, in the case of a QBU described in § 1.987-10(f)(1), if the election is made for any taxable year).

(2) *Computation of pre-election section 987 gain or loss*—(i) *In general*. Except as provided in paragraph (e)(2)(ii) or (iii) of this section, an exempt CFC's *pre-election section 987 gain or loss* with respect to a section 987 QBU, successor deferral QBU, or successor suspended loss QBU is equal to—

(A) The exempt CFC's net unrecognized section 987 gain or loss (as determined under § 1.987-4) with respect to a section 987 QBU for the taxable year immediately preceding the first taxable year in which the CFC exemption election applies, reduced by the amount of the net unrecognized section 987 gain or loss that is recognized, suspended, or deferred in the preceding taxable year;

(B) The exempt CFC's outstanding deferred section 987 gain or loss (as determined under § 1.987-12) with respect to a successor deferral QBU for the taxable year immediately preceding the first taxable year in which the election applies, reduced by the amount of the outstanding deferred section 987 gain or loss that is recognized, suspended, or attributed to a different successor deferral QBU in the preceding taxable year; and

(C) The exempt CFC's cumulative suspended section 987 loss (as determined under § 1.987-11) with respect to a section 987 QBU or successor suspended loss QBU for the taxable year immediately preceding the first taxable year in which the election applies, reduced by the amount of the suspended section 987 loss that is recognized, eliminated, or attributed to a different successor suspended loss QBU in the preceding taxable year. Suspended section 987 loss described in § 1.987-13(e) is not taken into account in determining pre-election section 987 gain or loss.

(ii) *Adjustments required if a current rate election is not in effect for the preceding taxable year*. Except as provided in paragraph (e)(2)(iii) of this section, if a current rate election is not in effect for the taxable year immediately preceding the first taxable year in which the CFC exemption election applies, pre-election section 987 gain or loss with respect to a section 987 QBU is adjusted to account for any change to the owner functional currency net value of the section 987 QBU attributable to the CFC exemption election. The amount of the adjustment is equal to—

(A) The owner functional currency net value of the section 987 QBU, determined under § 1.987-4(e) on the last day of the preceding taxable year as though a current rate election was in effect; minus

(B) The owner functional currency net value of the section 987 QBU, determined under § 1.987-4(e) on the last day of the preceding taxable year based on the elections in effect for the preceding taxable year.

(iii) *Pre-election section 987 gain or loss with respect to QBUs that hold assets of less than $50 million*—(A) *In general*. An exempt CFC is treated as having no pre-election section 987 gain or loss with respect to a section 987 QBU, successor deferral QBU, or successor suspended loss QBU described in paragraph (e)(2)(iii)(B) of this section.

(B) *QBUs that hold assets of less than $50 million*—(*1*) *In general*. A QBU is described in this paragraph (e)(2)(iii)(B) if the average amount of the QBU's assets for the last three taxable years before the first taxable year in which the CFC exemption election applies is less than $50 million. Any taxable year in which a QBU did not exist is not taken into account in computing the average amount of the QBU's assets for purposes of this paragraph (e)(2)(iii)(B).

(*2*) *Amount of assets*. For purposes of this paragraph (e)(2)(iii)(B), the amount of a QBU's assets for a taxable year is equal to the amount of total assets reflected on the QBU's balance sheet in accordance with generally accepted accounting principles on the last day of the taxable year (without regard to whether the assets are properly attributable to the QBU under § 1.987-2 and without adjustment to conform to federal income tax principles).

(*3*) *Aggregation rule*. All section 987 QBUs, successor deferral QBUs, and successor suspended loss QBUs of an exempt CFC that have the same country of residence (as defined in section 988(a)(3)(B)) are treated as a single QBU for purposes of this paragraph (e)(2)(iii).

(3) *Recognition of pre-election section 987 gain or loss*—(i) *In general*. An exempt CFC's pre-election section 987 gain or loss is recognized ratably over a period of 120 months under the rules of § 1.987-10(e)(5)(ii) (treating pre-election section 987 gain or loss in the same manner as pretransition gain or loss), subject to the modifications described in this paragraph (e)(3).

(ii) *Transition date*. In applying § 1.987-10(e)(5)(ii) with respect to pre-election section 987 gain or loss, the first taxable year in which a CFC exemption election applies is treated as the taxable year beginning on the transition date described in § 1.987-10(c)(1). Thus, in general, pre-election section 987 gain or loss is recognized ratably over a period of 120 months beginning with the first month of the first taxable year in which the CFC exemption election applies.

(iii) *Source and character*—(A) *Net unrecognized section 987 gain or loss*. The source and character of net unrecognized section 987 gain or loss that is recognized as pre-election section 987 gain or loss under this paragraph (e)(3) is determined under § 1.987-6. *See* § 1.987-6(b)(1)(v).

(B) *Deferred section 987 gain or loss and suspended section 987 loss*. The source and character of deferred section 987 gain or loss or suspended section 987 loss that is recognized as pre-election section 987 gain or loss under this paragraph (e)(3) is the same as the source and character determined under § 1.987-6 in the taxable year of deferral or suspension. *See* § 1.987-6(b)(1)(ii) and (iii).

(iv) *QBU ceases to be owned by a member of the exempt CFC's controlled group*—(A) *Scope*. This paragraph (e)(3)(iv) applies if pre-election section 987 loss of an exempt CFC is computed under paragraph (e)(2) of this section with respect to a section 987 QBU, successor deferral QBU, or successor suspended loss QBU, and, as result of a direct or indirect transfer, or an issuance or redemption, of an ownership interest in the exempt CFC during the 120-month period described in paragraph (e)(3)(i) of this section, the exempt CFC ceases to be a member of the same controlled group as the direct owner of the QBU (or the QBU's successor, determined under the principles of § 1.987-13(b) and (c)). For example, this paragraph (e)(3)(iv) applies if an exempt CFC is sold to an unrelated party, and the exempt CFC has unrecognized pre-election section 987 gain or loss with respect to a QBU that had previously been transferred by the exempt CFC to a member of its controlled group (either before or after the CFC exemption election took effect).

(B) *Pre-election section 987 loss suspended*. In the case of a transaction described in paragraph (e)(3)(iv)(A) of this section, the exempt CFC does not recognize any pre-election section 987 loss with respect to the QBU in the taxable year of the transaction and subsequent taxable years under this paragraph (e)(3). However, the exempt CFC continues to recognize pre-election section 987 gain with respect to the QBU under this paragraph (e)(3). Any pre-election section 987 loss that is not recognized under this paragraph (e)(3)(iv) is treated as suspended section 987 loss of the exempt CFC described in § 1.987-13(e).

(f) *First taxable year in which the election ceases to apply*—(1) *In general*. In the first taxable year in which a CFC exemption election ceases to apply to a CFC, each section 987 QBU of the CFC is deemed to be newly formed on the first day of the taxable year, and the assets and liabilities attributable to the section 987 QBU are deemed to be transferred from the owner to the section 987 QBU on that day.

(2) *Unrecognized pre-election section 987 gain or loss*—(i) *In general*. Except as provided in paragraph (e)(3)(iv) or (f)(2)(ii) of this section, if a CFC exemption election ceases to apply to a CFC, the CFC continues to recognize pre-election section 987 gain or loss under paragraph (e)(3) of this section.

(ii) *Revocation within sixty months*. If a CFC exemption election ceases to apply to a CFC within sixty months after the first day of the first taxable year for which the election applied to the CFC, any pre-election section 987 loss of the CFC that was not recognized under paragraph (e)(3) of this section before the taxable year in which the election ceases to apply is treated as suspended section 987 loss and is not recognized by the CFC under paragraph (e)(3) of this section.

(g) *Partnerships*. This paragraph (g) provides rules for applying this section with respect to an exempt partnership QBU.

(1) *Taxable year beginning on the transition date*. An exempt CFC or exempt partnership must compute and recognize pre-election section 987 gain or loss with respect to an exempt partnership QBU under paragraph (e) of this section regardless of whether the CFC exemption election is made for the taxable year beginning on the transition date described in § 1.987-10(c)(1) or a later taxable year.

(2) *Pre-election section 987 gain or loss*. For purposes of determining pre-election section 987 gain or loss under paragraph (e)(2)(i) of this section, net unrecognized section 987 gain or loss with respect to an exempt partnership QBU is equal to the amount of gain or loss that the owner would recognize under section 987(3) if the exempt partnership QBU terminated on the last day of the preceding taxable year and no section 987 gain or loss was deferred or suspended.

(3) *Exempt partnership*—(i) *In general*. An exempt partnership that is treated as the owner of a section 987 QBU (or is treated as an original deferral QBU owner or an original suspended loss QBU owner) must compute pre-election section 987 gain or loss in the same manner as an exempt CFC.

(ii) *Recognition of pre-election section 987 gain or loss*—(A) *In general*. An exempt partnership does not recognize pre-election section 987 gain or loss under paragraph (e)(3) of this section. Instead, each partner in the exempt partnership (other than a partner that is itself a partnership) treats its share of the exempt partnership's pre-election section 987 gain or loss as pre-election section 987 gain or loss of the partner that is recognized by the partner in accordance with paragraph (e)(3) of this section. *See* § 1.987-7(b)(2)(ii) (treating an indirect partner as a partner for purposes of the section 987 regulations).

(B) *Partner's share of pre-election section 987 gain or loss*. A partner's share of an exempt partnership's pre-election section 987 gain or loss with respect to a QBU is determined based on the amount of section 987 gain or loss with respect to the QBU that would be included in the partner's distributive share of profits or losses if the exempt partnership recognized the entire amount of pre-election section 987 gain or loss in the first taxable year for which the CFC exemption election applies. The principles of section 706(d) apply in making this determination.

(iii) *Partnership becomes an exempt partnership*. In a taxable year in which a partnership becomes an exempt partnership (for example, because 80 percent of the capital or profits interests in the partnership are acquired by an exempt CFC), the rules of this section are applied with respect to the exempt partnership by treating that taxable year as the first taxable year in which the CFC exemption election applies.

(iv) *Partnership ceases to be an exempt partnership*. In a taxable year in which a partnership ceases to be an exempt partnership, the rules of this section are applied with respect to the partnership by treating that taxable year as the first taxable year in which the CFC exemption ceases to apply.

(h) *Examples*. The following examples illustrate the rules of this section. The examples are not intended to illustrate the appropriate determination of any QBU's functional currency.

(1) *Example 1: CFC exemption election*—(i) *Facts*. U.S. Corp is a domestic corporation that uses the calendar year as its taxable year and has the U.S. dollar as its functional currency. U.S. Corp owns 100 percent of the stock of CFC 1, a controlled foreign corporation within the meaning of section 957(a), which has the U.S. dollar as its functional currency. CFC 1 operates Branch, a section 987 QBU which has the euro as its functional currency. Branch held assets of at least $50 million within the meaning of paragraph (e)(2)(iii)(B) of this section for each of the three taxable years preceding Year 1. In Year 1 (a taxable year beginning after the transition date described in § 1.987-10(c)(1)), a current rate election is in effect. As of December 31, Year 1, CFC 1 has net unrecognized section 987 gain of $1,200x with respect to Branch; CFC 1 does not have any outstanding deferred section 987 gain or loss or cumulative suspended section 987 loss. For Year 2, U.S. Corp makes a CFC exemption election with respect to CFC 1. Branch does not make a remittance to U.S. Corp in Year 1. On July 1, Year 2, Branch transfers an asset with a basis of €400x to CFC 1. CFC 1 does not make any transfers to Branch in Year 2. The spot rate on July 1, Year 2, is €1 = $1.10.

(ii) *Analysis*—(A) *Pre-election section 987 gain or loss*. Under paragraph (e)(2) of this section, CFC 1's pre-election section 987 gain or loss with respect to Branch equals a gain of $1,200x (the amount of net unrecognized section 987 gain or loss at the end of Year 1). Under paragraph (e)(3) of this section, CFC

1 must recognize the $1,200x of pre-election section 987 gain ratably over 120 months ($10x per month), beginning on January 1, Year 2. Accordingly, CFC 1 recognizes $120x of pre-election section 987 gain in Year 2 ($10x per month x 12 months).

(B) *Effect of election*. Under paragraph (b) of this section, CFC 1 does not compute or recognize any section 987 gain or loss under § 1.987-5 for Year 2, notwithstanding the transfer of the asset from Branch to CFC 1 on July 1, Year 2. Under paragraph (b)(3)(i) of this section, the applicable rules of the section 987 regulations are applied as if a current rate election was in effect. As a result, the asset transferred from Branch to CFC 1 is treated as a marked item under § 1.987-1(d)(2). Under § 1.987-5(f)(2), CFC 1's basis in the transferred asset is determined by translating its basis (€400x) into dollars at the spot rate applicable on the date of the transfer (€1 = $1.10). Therefore, CFC 1's basis in the asset equals $440x.

(2) *Example 2: Consistency rule*—(i) *Facts*. FP is a foreign partnership which directly owns 100 percent of the stock of US 1 and US 2, each of which is a domestic corporation that uses the calendar year as its taxable year and has the U.S. dollar as its functional currency. US 1 and US 2 are not affiliates within the meaning of § 1.904(i)-1(b). US 1 directly owns 100 percent of the stock of CFC 1, and US 2 directly owns 100 percent of the stock of CFC 2. CFC 1 and CFC 2 are controlled foreign corporations within the meaning of section 957(a). In Year 1, a CFC exemption election is in effect with respect to CFC 1 but not CFC 2. On July 1, Year 1, US 1 sells all of the stock of CFC 1 to US 2 with a principal purpose of causing a deemed revocation of the CFC exemption election with respect to CFC 1.

(ii) *Analysis*—(A) *Application of the general consistency requirement*. Before July 1, Year 1, US 1 and CFC 1 are members of a section 987 electing group within the meaning of § 1.987-1(g)(2) because US 1 owns more than 50 percent of the stock of CFC1. Similarly, because US 2 owns more than 50 percent of the stock of CFC2, US 2 and CFC 2 are members of a section 987 electing group. US 1 and US 2 are not members of the same section 987 electing group because they are not affiliates within the meaning of § 1.904(i)-1(b). However, US 1 and US 2 are members of the same controlled group as defined in § 1.987-1(h). As a result of US 2's acquisition of the stock of CFC 1, CFC 1 becomes a member of the US 2 section 987 electing group. Therefore, unless the anti-avoidance rule in paragraph (c)(3) of this section applies, the CFC exemption election would be deemed to be revoked with respect to CFC 1 as of January 1, Year 1. *See* § 1.987-1(g)(2).

(B) *Anti-avoidance rule*. US 2 acquired the stock of CFC 1 from US 1 with a principal purpose of causing a deemed revocation of the CFC exemption election with respect to CFC 1. Accordingly, under paragraph (c)(3)(i)(A) of this section, the CFC exemption election with respect to CFC 1 remains in effect for Year 1. In addition, under paragraph (c)(3)(ii) of this section, US 2 is deemed to make a CFC exemption election with respect to CFC 2 beginning in Year 1.

Par. 8. Section 1.987-16 is added to read as follows:

§ 1.987-16 Special rules for inbound nonrecognition transactions.

(a) *Overview*. This section provides rules relating to inbound nonrecognition transactions. Paragraph (b) of this section describes the scope of this section's application. Paragraphs (c) and (d) of this section provide rules for, respectively, computing and recognizing the amount of a transferor CFC's section 987 asset basis with respect to an inbound nonrecognition transaction. Paragraph (e) of this section provides a de minimis rule. Paragraph (f) of this section provides an example that illustrates the application of the rules of this section.

(b) *Scope*—(1) *In general*. This section applies if a domestic corporation (the *domestic acquiring corporation*) acquires the assets of a CFC (the *transferor CFC*) in either a liquidation described in section 332 or an asset acquisition described in section 368(a)(1) (an *inbound nonrecognition transaction*), and the transferor CFC was subject to a CFC exemption election for any taxable year ending during the pre-transaction period described in paragraph (b)(2) of this section. For purposes of this section, references to the transferor CFC include any CFC that transferred its assets to the transferor CFC in a transaction described in section 381(a) during the pre-transaction period.

(2) *Pre-transaction period*. For purposes of this section, the *pre-transaction period* is the period beginning 72 months before the inbound nonrecognition transaction and ending on the date of the inbound nonrecognition transaction.

(c) *Computation of section 987 asset basis*—(1) *Choice of methodology*. A transferor CFC is required to compute the amount of its section 987 asset basis under either the lookback methodology described in paragraph (c)(2) of this section or the excess asset basis methodology described in paragraph (c)(3) of this section. The same methodology must be applied with respect to all inbound nonrecognition transactions entered into as part of the same plan or arrangement. The amount of section 987 asset basis computed under this paragraph (c) cannot be less than zero.

(2) *Lookback methodology*—(i) *In general.* If a taxpayer uses the methodology described in this paragraph (c)(2), a transferor CFC's section 987 asset basis is equal to the sum of the transferor CFC's annual unrecognized section 987 gain or loss determined under § 1.987-10(e)(3)(iii) (or, if applicable, under paragraph (c)(2)(iv) of this section) for each pre-transaction taxable year described in paragraph (c)(2)(ii) of this section with respect to each section 987 QBU described in paragraph (c)(2)(iii) of this section. Paragraph (c)(2)(v) of this section provides rules for computing a transferor CFC's section 987 asset basis with respect to an exempt partnership.

(ii) *Pre-transaction taxable year*. A *pre-transaction taxable year* is a taxable year ending during the pre-transaction period, if a CFC exemption election was in effect for the taxable year.

(iii) *Section 987 QBUs*. Annual unrecognized section 987 gain or loss must be computed with respect to each section 987 QBU (including each exempt partnership QBU) owned by the transferor CFC in a pre-transaction taxable year. Thus, for example, if the transferor CFC owned a section 987 QBU during a pre-transaction taxable year, and the section 987 QBU was terminated or the CFC exemption election was revoked before the inbound nonrecognition transaction occurred, annual unrecognized section 987 gain or loss must nevertheless be computed with respect to the section 987 QBU for the taxable years preceding the termination or revocation.

(iv) *Annual unrecognized section 987 gain or loss with respect to an exempt partnership QBU*. In the case of an exempt partnership QBU, annual unrecognized section 987 gain or loss for a taxable year is equal to the amount of gain or loss that the owner would have recognized under section 987(3) if the QBU was formed on the first day of the taxable year (or, if later, the date on which the QBU was actually formed) and terminated on the last day of the taxable year (or, if earlier, the date on which the QBU was actually terminated). This amount must be determined without regard to the CFC exemption election (and without regard to the rules of §§ 1.987-7(d) and 1.987-11 through 1.987-13) using a reasonable method that is applied consistently with respect to all partnerships in which the transferor CFC is a partner.

(v) *Exempt partnerships*—(A) *In general*. If the transferor CFC is a partner in an exempt partnership in a pre-transaction taxable year, the transferor CFC's section 987 asset basis must be determined by taking into account the transferor CFC's share of the exempt partnership's annual unrecognized section 987 gain or loss (determined under paragraph (c)(2)(iv) of this section) with respect to each section 987 QBU owned by the exempt partnership for each pre-transaction taxable year in which the partnership was an exempt partnership. This amount is translated, if necessary, into the transferor CFC's functional currency at the spot rate on the date of the inbound nonrecognition transaction.

(B) *Transferor CFC's share of an exempt partnership's annual unrecognized section 987 gain or loss*. The transferor CFC's share of an exempt partnership's annual unrecognized section 987 gain or loss with respect to a section 987 QBU for a taxable year is equal to the amount of section 987 gain or loss that would be included in the transferor CFC's distributive share of profits or losses with respect to the section 987 QBU for the taxable year if the exempt partnership recognized the annual unrecognized section 987 gain or loss in the taxable year. The principles of section 706(d) apply in making this determination.

(3) *Excess asset basis methodology*. If a taxpayer uses the excess asset basis methodology described in this paragraph (c)(3), a transferor CFC's section 987 asset basis with respect to an inbound nonrecognition transaction is equal to the amount of excess asset basis determined under § 1.367(b)-3(g)(2)(i) with respect to the transferor CFC. This amount is translated (if necessary) into the transferor CFC's functional currency at the spot rate on the date of the inbound nonrecognition transaction. Notwithstanding § 1.367(b)-3(g)(2)(i), for purposes of this paragraph (c)(3), excess asset basis is determined without regard to the application of paragraph (d) of this section.

(d) *Recognition of section 987 gain equal to the amount of section 987 asset basis*—(1) *In general.* Immediately before an inbound nonrecognition transaction, the transferor CFC is required to recognize section 987 gain equal to the amount of its section 987 asset basis.

(2) *Source and character*—(i) *In general*. The source and character of section 987 gain recognized under paragraph (d)(1) of this section are determined under the rules of § 1.987-6, subject to the modifications described in paragraph (d)(2)(ii) of this section. *See* § 1.987-6(b)(1)(vi).

(ii) *Initial assignment is made by reference to all of the transferor CFC's assets*. Notwithstanding § 1.987-6(b)(2)(i)(A), for purposes of the initial assignment, section 987 gain recognized under paragraph (d)(1) of this section is assigned to the statutory and residual groupings in the same proportions as the proportions in which the tax book value of the assets of the transferor CFC (other than stock described in § 1.987-2(b)(2)(i)(A)) are assigned to the groupings under the asset method in §§ 1.861-9(g) and 1.861-9T(g) in the taxable year of the initial assignment.

(e) *De minimis rule*—(1) *In general*. The rules of paragraphs (c) and (d) of this section do not apply to an inbound nonrecognition transaction if the transferor CFC's inside asset basis is less than $25 million. If multiple inbound nonrecognition transactions occur as part of the same plan or arrangement, all transferor CFCs' assets are aggregated for this purpose.

(2) *Inside asset basis*. In general, for purposes of paragraph (e)(1) of this section, a transferor CFC's inside asset basis is determined under § 1.367(b)-3(g)(2)(iv). However, the basis of stock of a corporation owned by the transferor CFC that is described in § 1.987-2(b)(2)(i)(A) is taken into account only to the extent of the transferor CFC's aggregate adjusted basis in assets (other than stock described in § 1.987-2(b)(2)(i)(A)) or the amount of the transferor CFC's functional currency that was exchanged for stock of the CFC (for example, in a transaction to which section 351 applies) during the pre-transaction period.

(f) *Example*: *Computation of section 987 asset basis*. The following example illustrates the rules of this section. For purposes of this example, except as otherwise indicated, no section 987 elections are in effect. This example is not intended to illustrate the appropriate determination of any QBU's functional currency.

(1) *Facts*—(i) *In general*. U.S. Corp is a domestic corporation that uses the calendar year as its taxable year and has the U.S. dollar as its functional currency. U.S. Corp owns 100 percent of the stock of CFC 1 (a controlled foreign corporation within the meaning of section 957(a)), which also uses the calendar year as its taxable year and has the U.S. dollar as its functional currency. CFC 1 forms Business A, a section 987 QBU with the euro as its functional currency, at the beginning of Year 1. At the beginning of Year 1, U.S. Corp's adjusted basis in the stock of CFC 1 is zero, and no assets or liabilities of CFC 1 are attributable to Business A. A CFC exemption election is in effect with respect to CFC 1 beginning in Year 1.

(ii) *Exchange rates.* The spot rate on December 31, Year 1, is €1 = $1.15. The yearly average exchange rate for Year 1 is €1 = $1.10. The spot rate on June 30, Year 2 is €1 = $1.25.

(iii) *Year 1 income and activities*. In Year 1, Business A earns income of €100x, which is subpart F income. Business A purchases Property X, a nondepreciable asset, for €100x. Under § 1.987-3(c), Business A's income of €100x is translated into CFC 1's functional currency at the yearly average exchange rate of €1 = $1.10. Therefore, CFC 1 has $110x of subpart F income (€100x x ($1.10 / €1)). Under section 961(a), U.S. Corp's adjusted basis in the stock of CFC 1 is increased by $110x.

(iv) *Liquidation of CFC 1*. On June 30, Year 2, CFC 1 distributes Property X to U.S. Corp in a liquidation to which section 332 applies. Immediately before the liquidation, CFC 1 and Business A have no liabilities and no assets other than Property X. CFC1 has inside asset basis of at least $25 million.

(2) *Analysis*—(i) *Termination of Business A QBU*. Under § 1.987-8(b)(4) and (c)(1)(ii), the Business A QBU terminates as a result of the liquidation of CFC 1. Therefore, under § 1.987-8(e), Business A is deemed to transfer Property X to CFC 1 immediately before the termination, on June 30, Year 2. As a result, immediately before the liquidation, CFC 1's basis in Property X is $125x (equal to Business A's basis of €100x, translated at the June 30, Year 2, spot rate of €1 = $1.25). *See* § 1.987-5(f)(2).

(ii) *Computation of section 987 asset basis*—(A) *In general*. CFC 1 was subject to a CFC exemption election during the pre-transaction period described in paragraph (b)(2) of this section. Thus, under paragraph (d) of this section, CFC 1 is required to recognize section 987 gain immediately before the liquidation in an amount equal to its section 987 asset basis. Under paragraph (c) of this section, CFC 1 may compute the amount of section 987 asset basis using either the lookback methodology or the excess asset basis methodology.

(B) *Lookback methodology*—(*1*) *In general*. Under the lookback methodology provided in paragraph (c)(2) of this section, CFC 1's section 987 asset basis is equal to the sum of its annual unrecognized section 987 gain or loss with respect to Business A determined under § 1.987-10(e)(3)(iii) for each pre-transaction taxable year. For each taxable year, CFC 1's annual unrecognized section 987 gain or loss with respect to Business A is calculated by applying only Steps 1 and 10 of the ten-step determination under § 1.987-4(d). CFC 1's pre-transaction taxable years are the full taxable year beginning January 1, Year 1, and the short taxable year beginning January 1, Year 2, and ending June 30, Year 2. As explained in paragraph (f)(2)(ii)(B)(*2*) of this section, CFC 1 has annual unrecognized section 987 gain of $5x in Year 1, and CFC 1 has annual unrecognized section 987 gain of $10x in Year 2. Thus, under the lookback methodology, CFC 1's section 987 asset basis equals $15x ($5x + $10x), and CFC 1 recognizes $15x of section 987 gain under paragraph (d)(1) of this section.

(*2*) *Annual unrecognized section 987 gain or loss*—(*i*) *Year 1*. For Year 1, CFC 1's annual unrecognized section 987 gain equals $5. The change in owner functional currency net value (Step 1) equals $115x (€100x x ($1.15 / €1) – 0). Step 10 reduces this amount by the residual increase to net assets determined in Business A's functional currency (the €100x basis in Property X), translated into CFC 1's functional currency at the yearly average exchange rate (€1 = $1.10). Thus, the reduction in Step 10 equals $110x, and CFC 1 has annual unrecognized gain of $5x ($115x - $110x).

(*ii*) *Year 2*. For short Year 2, CFC 1's annual unrecognized section 987 gain equals $10x. This is equal to the amount determined in Step 1. The Step 1 amount is $10x, equal to the difference in Business A's €100x balance sheet translated into CFC 1's functional currency at the spot rate on the last day of Year 2 (€1 = $1.25) and the spot rate on the last day of Year 1 (€1 = $1.15). The Step 10 amount for Year 2 is zero because there is no residual increase or decrease to Business A's net assets as determined in Business A's functional currency; throughout Year 2, Business A had net assets of €100x.

(C) *Excess asset basis methodology*. Under the excess asset basis methodology provided in paragraph (c)(3) of this section, CFC 1's section 987 asset basis is equal to the amount of excess asset basis determined under § 1.367(b)-3(g)(2)(i). Under § 1.367(b)-3(g)(2)(i) (applied without regard to paragraph (d) of this section), the excess asset basis is equal to CFC 1's inside asset basis (determined in the hands of U.S. Corp immediately after the liquidation of CFC 1) minus the sum of CFC 1's earnings and profits (excluding previously taxed earnings and profits); U.S. Corp's aggregate basis in the stock of CFC 1 immediately before the liquidation of CFC 1; and the aggregate amount of any liabilities assumed by U.S. Corp as a result of the liquidation of CFC 1. CFC 1's inside asset basis equals $125x, as explained in paragraph (f)(2)(iii) of this section. CFC 1 has no earnings and profits (other than previously taxed earnings and profits), and no liabilities. U.S. Corp's aggregate basis in the stock of CFC 1 is $110x. Accordingly, the excess asset basis with respect to CFC 1 is $15x ($125x minus $110x). Thus, under the excess asset basis methodology, CFC 1's section 987 asset basis equals $15x, and CFC 1 recognizes $15x of section 987 gain under paragraph (d)(1) of this section.

(iii) *Liquidation of CFC 1*. For purposes of section 334(b), section 987 gain recognized under paragraph (d) of this section is not treated as gain recognized with respect to property distributed by CFC 1 in the liquidation, because the gain is recognized immediately before the liquidation. Therefore, under section 334(b), U.S. Corp receives Property X with a basis of $125x.

Par. 9. Newly redesignated § 1.987-17 is amended by adding paragraphs (e) and (f) to read as follows:

§ 1.987-17 Applicability date.

* * * * *

(e) *Applicability date of 120-month amortization rule*. Section 1.987-10(e)(5)(ii) applies to taxable years beginning after December 31, 2024, and ending on or after November 25, 2025. *See* § 1.987-15, as contained in 26 CFR in part 1 in effect on April 1, 2025, for a prior applicability date for § 1.987-10(e)(5)(ii).

(f) *Applicability date of rules relating to the CFC exemption election.* Sections 1.987-1(g)(2)(iv) and (g)(3)(ii)(D), 1.987-6(b)(1)(v) and (vi), 1.987-7(b)(2), (c)(2)(iv), and (d)(2)(iv), and 1.987-15 apply to taxable years ending on or after [date of filing of final regulations with the **Federal Register**]. Section 1.987-16 applies to transactions completed within taxable years of a domestic acquiring corporation ending on or after [date of filing of final regulations with the **Federal Register**]. *See* § 1.987-15, as contained in 26 CFR in part 1 in effect on April 1, 2025, for a prior applicability date for § 1.987-7(b).

Frank J. Bisignano,
Chief Executive Officer.

(Filed by the Office of the Federal Register August 13, 2026, 8:45 a.m., and published in the issue of the Federal Register for August 14, 2026, 91 FR 52553)

Notice of Proposed Rulemaking

Section 898(c) Transition Rule for Allocating Foreign Taxes and Section 960(d)(4) Foreign Tax Credit Disallowance

REG-115145-25

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that relate to allocating foreign taxes of foreign corporations affected by the repeal of the one-month deferral election and to the disallowance of foreign tax credits on certain distributions of previously taxed earnings and profits. The proposed regulations would affect taxpayers that operate in foreign countries through certain foreign corporations and taxpayers that claim the foreign tax credit.

DATES: Written or electronic comments and requests for a public hearing must be received by September 17, 2026.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG-115145-25) by following the online instructions for submitting comments. Requests for a public hearing must be submitted as prescribed in the "Comments and Requests for a Public Hearing" section. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted to the IRS's public docket. Send paper submissions to: CC:PA:01:PR (REG-115145-25), Room 5503, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations related to section 898(c), Hayley Rassuchine at (202) 317-6936; concerning the proposed regulations related to section 960(d)(4), Le Chen at (202) 317-6936; and concerning submissions of comments and requests for a public hearing, Publications and Regulations at (202) 317-6901 (not toll-free numbers) or by sending an email to *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Authority

This document contains proposed additions and amendments to 26 CFR part 1 (proposed regulations) under sections 898(c) and 960(d)(4) and certain other provisions of the Internal Revenue Code (Code). The proposed regulations are issued pursuant to the express delegation of authority under section 70352(c) of Public Law 119-21, 139 Stat. 72 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA), which provides that the Secretary of the Treasury or the Secretary's delegate (Secretary) shall issue regulations providing for the allocation of foreign taxes of foreign corporations affected by the repeal of section 898(c)(2). The proposed regulations are also issued pursuant to the express delegation of authority under section 960(f), which provides the Secretary with authority to prescribe such regulations as may be necessary or appropriate to carry out the provisions of section 960. Additionally, the proposed regulations are issued pursuant to the express delegation of authority under section 7805(a).

Background

I. *Repeal of Section 898(c)(2)*

Section 898 provides rules for determining the required taxable year of any specified foreign corporation. A foreign corporation is a specified foreign corporation if it is treated as a controlled foreign corporation (CFC) for any purpose under subpart F of subchapter N of chapter 1 of subtitle A of the Code, and if any United States shareholder (as defined in section 951(b)) (U.S. shareholder) owns (determined by applying the ownership rules of section 958) more than 50 percent of the stock of the CFC by vote or value on each testing day[1] (majority U.S. shareholder).

Section 898(c)(1) generally requires a specified foreign corporation to have the same taxable year as the taxable year of its majority U.S. shareholder (the majority U.S. shareholder year). However, prior to the enactment of the OBBBA, section 898(c)(2) generally permitted a specified foreign corporation to elect a taxable year beginning one month earlier than the majority U.S. shareholder year (one-month deferral election), subject to the consent of the Secretary. Section 70352 of the OBBBA repealed the one-month deferral election for taxable years of specified foreign corporations beginning after November 30, 2025. Section 70352(c) of the OBBBA provides that if a corporation is a specified foreign corporation as of November 30, 2025, its first taxable year beginning after November 30, 2025, will end at the same time as the first required year (within the meaning of section 898(c)(1)) ending after such date (first required year). Thus, a specified foreign corporation with a one-month deferral election in place will have a one-month taxable year as its first required year.

Section 70352(c) of the OBBBA provides a transition rule for specified foreign corporations required to change their taxable years due to the repeal of the one-month deferral election (the transition rule). Under the transition rule, the change to the specified foreign corporation's taxable year will be treated as initiated by the corporation and as having been made with the consent of the Secretary. The transition rule also directs the Secretary to issue regulations or other guidance allocating foreign taxes paid or accrued in the specified foreign corporation's first required year and its succeeding taxable year among those taxable years in the manner the Secretary determines appropriate to carry out the purposes of section 70352 of the OBBBA.

On November 25, 2025, the Treasury Department and the IRS issued Notice 2025-72, 2025-51 I.R.B. 840, describing rules expected to be included in forthcoming proposed regulations under: (1) section 70352 of the OBBBA regarding the transition rule, and (2) section 987 regarding the election to recognize pretransition section 987 gain or loss ratably over a transition period. The proposed regulations would contain the rules described in Notice 2025-72 related to the transition rule, with certain modifications discussed in this preamble, and other guidance but would not include the rules related to pretransition section 987 gain or loss. The Treasury Department and the IRS intend to issue a separate notice of proposed rulemaking in the near future relating to section 987 that includes proposed rules relating to the recognition of pretransition section 987 gain or loss.

II. *Section 960(d)(4)*

Section 901 generally provides that a taxpayer choosing to credit foreign income taxes is allowed a credit for certain foreign income taxes paid or accrued by the taxpayer plus, in the case of a domestic corporation, the taxes deemed to have been paid by the domestic corporation under section 960. Section 960(d) provides that, if any amount is includible in the gross income of a domestic corporation under section 951A (section 951A inclusion), the domestic corporation is deemed to have paid foreign income taxes with respect to the section 951A inclusion. Prior to the OBBBA, section 960(d)(1) provided that a domestic corporation that is a U.S. shareholder is deemed to have paid foreign income taxes in an amount equal to 80 percent of the product of the U.S. shareholder's inclusion percentage and the aggregate of the tested foreign income taxes paid or accrued by its CFCs. Thus, section 960(d)(1) (prior to the OBBBA) effectively reduced the amount of foreign income taxes deemed paid with respect to a section 951A inclusion by 20 percent.

Section 70312(a)(1) of the OBBBA increased the percentage in section 960(d)(1) from 80 percent to 90 percent, thereby decreasing the reduction in foreign income taxes deemed paid from 20 percent to 10 percent. Section 70312(b) of the OBBBA added section 960(d)(4) to the Code, which correspondingly disallows a foreign tax credit for 10 percent of the foreign income taxes paid or accrued (or deemed paid under section 960(b)(1)) with respect to a distribution of previously taxed earnings and profits (PTEP) resulting from a section 951A inclusion. Section 70312(c)(2) of the OBBBA provides that section 960(d)(4) applies to foreign income taxes paid or accrued (or deemed paid under section 960(b)(1)) with respect to any amount excluded from gross income under section 959(a) by reason of a section 951A inclusion after June 28, 2025.

[1] Section 898(c)(3)(B) (redesignated by section 70352(a) of the OBBBA as section 898(c)(2)(B)) defines the testing days as the first day of the corporation's taxable year, or the days during a representative period that the Secretary may prescribe. No final regulations have been issued that prescribe such a representative period.

On December 4, 2025, the Treasury Department and the IRS issued Notice 2025-77, 2025-52 I.R.B. 872, announcing the intent to issue proposed regulations regarding section 960(d)(4), including the application of the effective date of section 960(d)(4). Notice 2025-77 provides guidance for determining the amount of foreign income taxes paid or accrued (or deemed paid) with respect to PTEP distributions resulting from a section 951A inclusion that are subject to the foreign tax credit disallowance under section 960(d)(4). The proposed regulations contain the rules described in Notice 2025-77.

Explanation of Provisions

I. *Proposed Regulations Implementing the Section 898(c) Transition Rule*

A. *Relevant foreign tax credit framework*

In general, under section 951(a)(1),[2] a U.S. shareholder of a CFC must include in gross income its pro rata share of the CFC's subpart F income for the year. Similarly, a U.S. shareholder's section 951A inclusion is based, in part, on its pro rata share of its CFC's tested income or tested loss for the taxable year. *See* § 1.951A-1(c). In computing a CFC's items of subpart F income and its tested income or tested loss, deductions (including taxes) properly allocable to such income are taken into account. *See, e.g.*, sections 954(b)(5) and 951A(b)(2)(A)(ii). A CFC's items of subpart F income and its tested income or tested loss are computed in the functional currency of the CFC and translated into U.S. dollars as net amounts using the average exchange rate for the CFC's taxable year. *See* sections 986(b) and 989(b)(3) and § 1.951A-1(d)(1).

Generally, an income item of a CFC that would otherwise be subpart F income may be excluded, pursuant to an election, under the high-tax exception from foreign base company income (high-tax exception) if the item is subject to an effective rate of foreign tax that is greater than 90 percent of the maximum rate of tax specified in section 11. *See* § 1.954-1(d). A similar election excludes from tested income an item that would otherwise be tested income (high-tax exclusion) if the item is subject to an effective rate of foreign tax greater than 90 percent of the maximum rate of tax specified in section 11. *See* § 1.951A-2(c)(7).

Section 960(a) provides that when a domestic corporation includes in gross income any item of income under section 951(a)(1) with respect to a CFC, the domestic corporation is deemed to have paid so much of the CFC's foreign income taxes as are properly attributable to the item of income. Section 960(d)(1) provides that when a domestic corporation has a section 951A inclusion, the domestic corporation is deemed to have paid 90 percent of the product of such domestic corporation's inclusion percentage multiplied by the aggregate tested foreign income taxes paid or accrued by its CFCs. Section 960(d)(3) defines tested foreign income taxes as the foreign income taxes paid or accrued by a CFC which are properly attributable to the tested income of the CFC taken into account by the domestic corporation under section 951A. Therefore, in order for foreign income taxes paid or accrued by a CFC in a taxable year to be deemed paid by a U.S. shareholder, the related subpart F income of the CFC must be included in gross income by the U.S. shareholder under section 951(a)(1), or the related tested income of the CFC must be taken into account in the U.S. shareholder's section 951A inclusion. Section 960(b)(1) provides that a U.S. shareholder of a CFC is deemed to have paid the CFC's foreign income taxes that the U.S. shareholder has not been previously deemed to pay and that are properly attributable to a distribution from the CFC that the U.S. shareholder excludes from its gross income under section 959(a) (a section 959(a) distribution).

Section 1.861-20 provides rules for allocating and apportioning foreign income taxes to statutory and residual groupings for an operative Code section, except as modified under the rules for the operative section. *See also* § 1.861-8(f). These rules apply to attribute foreign income taxes paid or accrued by a CFC to items of income of the CFC in order to determine a CFC's net items of subpart F income and tested income, the effective rate of foreign tax for purposes of the high-tax exception and the high-tax exclusion, and the taxes attributable to the CFC's income groups and PTEP groups (as defined in § 1.960-1(b)). *See* §§ 1.960-1(d), 1.960-2(b)(2) and (c)(4), and 1.960-3(d).

The foreign income taxes taken into account by a CFC in a taxable year are determined under the CFC's method of accounting. For CFCs that use an accrual method of accounting, foreign income taxes accrue in the taxable year in which all the events have occurred that establish the fact of the liability and the amount of the liability can be determined with reasonable accuracy. *See* §§ 1.446-1(c)(1)(ii)(A) and 1.461-4(g)(6)(iii)(B). A foreign income tax determined on the basis of items of income, gain, deduction, and loss that arise in a foreign taxable year (a foreign net income tax) becomes fixed and determinable at the close of the foreign taxable year. *See* § 1.905-1(d)(1)(i). For CFCs that use the cash method of accounting, foreign income taxes are taken into account when paid. *See* §§ 1.905-1(c)(1) and 1.446-1(c)(1)(i). Foreign income taxes are generally considered paid in the taxable year in which the taxes are remitted to the foreign country.

Section 1.901-2(f) provides rules for determining the person considered to have paid or accrued a foreign income tax for foreign tax credit purposes (the section 901 taxpayer). For instance, a partnership is considered the section 901 taxpayer of a foreign income tax imposed at the entity level on the income of the partnership. *See* § 1.901-2(f)(4)(i). Additionally, the person who is treated as owning the assets of a disregarded entity (as described in § 301.7701-2(c)(2)(i)) for Federal income tax purposes is considered the section 901 taxpayer of any foreign income tax imposed at the entity level on the income of the disregarded entity. *See* § 1.901-2(f)(4)(ii). If a partnership, disregarded entity, or corporation undergoes one or more cov-

[2] The statutory citations in part I of this Explanation of Provisions section are to the Code as in effect following the amendments made by the OBBBA. While some of these amendments may not be applicable to a specified foreign corporation's first required year (depending on when that first required year begins), the amendments generally do not affect the proposed regulations implementing the section 898(c) transition rule.

ered events during its foreign taxable year that do not close the foreign taxable year, a foreign income tax, other than a withholding tax described in section 901(k)(1)(B), imposed with respect to that continuing foreign taxable year is allocated to and among the predecessor entities or prior owners under § 1.901-2(f)(5). Section 1.901-2(f)(5)(ii) defines a covered event as a partnership termination under section 708(b)(1), a transfer of a disregarded entity, or a change in entity classification of a disregarded entity or a corporation.

For purposes of determining the amount of the foreign tax credit, foreign income taxes are translated at the rate provided under section 986(a). If the section 901 taxpayer of the foreign income tax takes foreign income taxes into account when accrued, taxes are generally translated using the average exchange rate for the taxable year to which the taxes relate. *See* section 986(a)(1)(A). Section 986(a) provides certain exceptions to the general rule, including for foreign income taxes that are not paid within two years of the close of the U.S. taxable year to which they relate. *See* section 986(a)(1)(B). Section 905(c) provides that, among other things, a change in the amount of foreign income tax accrued and claimed as a credit requires a redetermination of the U.S. tax liability for the year or years affected.

B. *Foreign taxes subject to allocation*

1. Specified Foreign Income Taxes

Section 3.03 of Notice 2025-72 provides that only specified foreign income taxes would be allocated between the first required year and the succeeding taxable year of a specified foreign corporation. Section 3.02(4) of Notice 2025-72 defines a "specified foreign income tax" as a foreign net income tax accrued by an affected corporation in its first required year for which the affected corporation is the section 901 taxpayer. Section 3.02 of Notice 2025-72 defines an affected corporation as a specified foreign corporation (as defined in section 898(b)) that takes into account foreign income taxes under an accrual method of accounting and that, pursuant to section 70352(c) of the OBBBA, is required to change its first taxable year beginning after November 30, 2025. No comments were received on these definitions, and, except as discussed in this part I.B of this Explanation of Provisions section, the proposed regulations would apply to specified foreign income taxes and would define a "specified foreign income tax" and an "affected corporation" consistently with Notice 2025-72. *See* proposed § 1.898(c)-1(b) (clarifying the definition of an affected corporation to require that the specified foreign corporation's first required year end pursuant to section 70352(c)(1) of the OBBBA on the date prescribed by that section) and § 1.898(c)-1(c) (expanding the definition of a specified foreign income tax to include specified distributive shares of creditable foreign tax expenditures if an election is made). Thus, except as discussed in this part I.B of this Explanation of Provisions section, any other foreign tax that is taken into account by a specified foreign corporation in its first required year or its succeeding taxable year would continue to be taken into account in that respective taxable year.

The proposed regulations would allocate specified foreign income taxes between an affected corporation's first required year and its succeeding taxable year to carry out the purposes of section 70352 of the OBBBA. Specified foreign income taxes would generally include foreign net income taxes, which accrue on the last day of a foreign taxable year. As a result of section 70352(c) of the OBBBA, a specified foreign corporation's foreign taxable year may close with or within the specified foreign corporation's first required year. In that case, the foreign net income tax, likely imposed with respect to a full taxable year of foreign law income, accrues in the first required year while only one month of income accrues in that year for Federal income tax purposes. Depending on the amount of the foreign net income tax imposed, this could result in the specified foreign corporation having a loss with respect to a particular income group for the first required year, resulting in foreign income taxes not being deemed paid by the affected corporation's U.S. shareholders under section 960(a) or (d). *See* part I.A of this Explanation of Provisions section.

As under Notice 2025-72, the definition of specified foreign income tax would exclude taxes that are likely to accrue close in time to the related income since any allocation of such tax between the first required year and the succeeding taxable year would create a needless separation of income and tax. For instance, a specified foreign income tax would not include a foreign withholding tax because such a tax accrues close in time to the income to which it relates. Similarly, a specified foreign corporation that uses the cash method of accounting would not be an affected corporation, and foreign net income taxes taken into account by such a specified foreign corporation would not be specified foreign income taxes. A cash-basis specified foreign corporation will generally be required to make monthly or quarterly estimated payments of its foreign income tax liability and, therefore, is unlikely to make a single payment of foreign income tax in its first required year that would result in a loss with respect to a particular income group.

2. Specified Distributive Shares of Creditable Foreign Tax Expenditures

Section 3.03(1) of Notice 2025-72 provides that an affected corporation's distributive share of foreign income taxes paid or accrued by a partnership (creditable foreign tax expenditures or CFTEs, as defined in § 1.704-1(b)(4)(viii)) are not specified foreign income taxes, and therefore, would not be allocated between the affected corporation's first required year and its succeeding taxable year. Section 6 of Notice 2025-72 requested comments on whether an affected corporation's distributive share of CFTEs should be allocated between its first required year and succeeding taxable year when an affected corporation owns an interest in a partnership that is required to change its taxable year because the affected corporation changes its taxable year pursuant to section 70352 of the OBBBA. *See* section 706(b) and § 1.706-1(b). Several comments recommended that distributive shares of CFTEs of such partnerships be allocated between the affected corporation's first required year and succeeding taxable year.

As under Notice 2025-72, the proposed regulations would generally define a specified foreign income tax to exclude an affected corporation's distributive share of CFTEs. This exclusion prevents the separation of income and foreign income tax because the affected corporation will take into account its distributive share of other partnership items based on the partnership's full taxable year at the same time it takes into account its distributive share of CFTEs. *See* section 706(a) and § 1.706-1(a). However, when a partnership is required to change its taxable year because an affected corporation owning an interest in the partnership changes its taxable year pursuant to section 70352 of the OBBBA, the partnership would have a one-month taxable year with outcomes similar to those described in part I.B.1 of this Explanation of Provisions section. Accordingly, the proposed regulations would provide an election to treat all of an affected corporation's distributive shares of certain CFTEs of affected partnerships (specified distributive shares of CFTEs) as specified foreign income taxes. *See* proposed § 1.898(c)-1(c)(2); *see also* part I.E.2 of this Explanation of Provisions section regarding the procedural requirements for making the election.

3. Relevant Succeeding Year Taxes

Section 3.03(1) of Notice 2025-72 provides that foreign income taxes accrued by an affected corporation in its succeeding taxable year are not specified foreign income taxes and, therefore, would not be allocated between the affected corporation's first required year and its succeeding taxable year. Notice 2025-72 explains that while a foreign net income tax accrued in the succeeding taxable year may relate to income accrued in the first required year, the Treasury Department and the IRS expect that the administrative and compliance burdens of allocating a portion of the succeeding year tax to the first required year would exceed the benefits of allocation.

A comment noted that the repeal of section 898(c)(2) could result in a loss of foreign tax credits if the income accrued by an affected corporation in its first required year is different in type than the income accrued by the affected corporation in its succeeding taxable year. For instance, an affected corporation may have a first required year that ends December 31, 2025, and be subject to a foreign income tax with respect to a foreign taxable year that ends on March 31, 2026. The foreign income tax that accrues on March 31, 2026, could be imposed in part on the income that accrued for Federal income tax purposes in the affected corporation's first required year. If the affected corporation does not earn the same type of income in the succeeding taxable year, then a portion of the foreign income tax would not be deemed paid because the affected corporation will not have income in the relevant income group in the succeeding taxable year. The comment also noted that, in some cases, a taxpayer may have the necessary information to allocate the succeeding year taxes before the extended due date of the majority U.S. shareholder's Federal income tax return for the taxable year with which the affected corporation's first required year ends.

The Treasury Department and the IRS continue to be of the view that, in general, the administrative and compliance burdens of allocating a portion of the succeeding year tax to the first required year would exceed the benefits of allocation. Further, maintaining the full amount of foreign income taxes in the succeeding taxable year is appropriate because a full year's worth of foreign income taxes accrue with a full year of income. Accordingly, the proposed regulations would generally provide that foreign income taxes accrued by an affected corporation in its succeeding taxable year are not specified foreign income taxes.

However, the Treasury Department and the IRS agree with the comment that, in some cases, when an affected corporation's foreign taxable year (for example, a March 31 year end) does not align with its succeeding taxable year (for example, a December 31 year end), an allocation of an affected corporation's foreign income taxes accrued in the succeeding taxable year between its first required year and its succeeding taxable year is appropriate to address the concerns described in this part I.B.3 of this Explanation of Provisions section. Accordingly, to address these circumstances, the proposed regulations would provide an irrevocable election to allocate the affected corporation's relevant succeeding year taxes between the affected corporation's first required year and its succeeding taxable year. *See* proposed § 1.898(c)-1(f); *see also* part I.E.2 of this Explanation of Provisions section regarding the procedural requirements for making the election.

C. *Ordering rules*

Section 3.04 of Notice 2025-72 provides that a specified foreign income tax would be allocated between the affected corporation's first required year and its succeeding taxable year and then taken into account in each respective taxable year under certain ordering rules. These ordering rules would coordinate statutory and regulatory provisions related to the computation of an affected corporation's income items under sections 951(a) and 951A and the computation of the foreign taxes deemed paid under section 960(a) and (d) with the allocation of foreign income taxes between the affected corporation's first required year and succeeding taxable year. No comments were received on these ordering rules, and the rules, therefore, are included in the proposed regulations. *See* proposed § 1.898(c)-1(d).

D. *Allocation method*

1. Allocation Percentage

Section 3.05 of Notice 2025-72 provides that a specified foreign income tax would be allocated between an affected corporation's first required year and its succeeding taxable year by determining an allocation percentage for each specified foreign income tax. The allocation percentage would be equal to the portion of an affected corporation's taxable income, as determined under foreign law, that is attributable under the principles of § 1.1502-76(b) to the first required year, divided by the total taxable income, as determined under foreign law, for the foreign taxable year with respect to which the specified foreign income tax is imposed. A comment requested that the proposed regulations allow taxpayers to use any reasonable allocation method that aligns foreign taxes with the income to which those taxes relate, including an allocation of an affected corporation's foreign taxes to its taxable year preceding its first required year.

For the reasons described below, the proposed regulations would require the use of a single prescriptive allocation method to implement the transition rule. *See* proposed § 1.898(c)-1(e). The allocation method would reduce the likelihood that foreign income taxes of a specified foreign corporation in the first required year would not be deemed paid as a consequence of the repeal of section 898(c)(2). Additionally, the allocation method would leverage an existing methodology that is familiar to taxpayers for allocating foreign income taxes, *see, e.g.,* §§ 1.245A-5(e)(3)(i), 1.336-2(g)(3)(ii), 1.338-9(d), and 1.901-2(f)(5), and would use taxable income as determined under foreign law, which is an amount that taxpayers are already required to consider in applying § 1.861-20. Further, the allocation method would better accommodate affected corporations that may earn uneven amounts of income in the first required year, as compared to an allocation method that is based on a set ratio such as months or days. The allocation method would provide flexibility to taxpayers because the principles of § 1.1502-76(b) allow for either a closing of the books method or a ratable allocation method for purposes of determining the portion of taxable income attributable to the first required year. Finally, the method suggested by the comment would not comply with the requirement in section 70352(c) of the OBBBA to allocate foreign taxes between a specified foreign corporation's first taxable year and its succeeding taxable year, and not to an earlier taxable year.

2. Income Group Specific Allocation Percentage

Section 3.05 of Notice 2025-72 provides that a single allocation percentage based on an affected corporation's total taxable income, as determined under foreign law, for the foreign taxable year with respect to which the specified foreign income tax is imposed would apply to the amount of a specified foreign income tax assigned to each income group of the affected corporation. A comment stated that taxpayers generally have the information needed to compute a different allocation percentage for each income group, which may better match the tax allocated to the first required year to the income accrued in that year. By way of example, the comment described a situation in which an affected corporation (AC) with its first required year ending on December 31, 2025, and a foreign taxable year that ends on December 31, 2026, recognizes gain from the sale of stock on December 15, 2025. The gain is foreign personal holding company income described in section 954(c)(1)(B) within the passive category. Under § 1.861-20, as applied in the first required year, the Country X income tax attributable to the stock gain is allocated and apportioned to AC's relevant subpart F income group within the passive category. In its succeeding taxable year, however, AC does not recognize subpart F income in the relevant subpart F income group within the passive category. Any portion of Country X income tax assigned to that income group allocated to the succeeding taxable year under a single allocation percentage would not be deemed paid under section 960(a).

The Treasury Department and the IRS are of the view that, in most cases, determining a different allocation percentage for each income group would require taxpayers to undertake potentially burdensome analyses without providing benefits, and therefore, the proposed regulations would provide, as a general rule, a single allocation percentage that is used for all income groups. However, the Treasury Department and the IRS agree with the comment that in some cases a different allocation percentage for each income group may be appropriate. Accordingly, the proposed regulations would provide an election to apply a specific allocation percentage to the amount of a specified foreign income tax assigned to each income group of an affected corporation. *See* proposed § 1.898(c)-1(e)(3); *see also* part I.E.2 of this Explanation of Provisions section regarding the procedural requirements of the election. The proposed regulations would also provide that the income group specific allocation method is required for allocating a relevant succeeding year tax between an affected corporation's first required year and its succeeding taxable year. *See* proposed § 1.898(c)-1(f)(3). An income group specific allocation percentage is computed by applying the principles of § 1.1502-76(b), using the closing of the books method, separately for each income group to which foreign law income is assigned under § 1.861-20.

3. Election to Not Allocate

Section 3.04 of Notice 2025-72 provides that a specified foreign income tax would be allocated between an affected corporation's first required year and its succeeding taxable year and then would be taken into account in each respective taxable year. A comment requested an election to forgo the allocation rule set forth in the notice and instead apply current accrual rules to specified foreign income taxes in order to allow an affected corporation's controlling domestic shareholders to determine whether these existing rules better serve their interests.

The proposed regulations adopt this comment because the Treasury Department and the IRS believe it would reduce compliance burdens. The proposed regulations would provide an election to not allocate an affected corporation's specified foreign income taxes. If the election is made, the specified foreign income taxes would be taken into account in the affected corporation's first required year. *See* proposed § 1.898(c)-1(e)(4); *see also* part I.E of this Explanation of Provisions section regarding other procedural requirements for making the election. This election would apply to all specified foreign income taxes of an affected corporation. If the election is made, the affected corporation's relevant succeeding year taxes may not be allocated between its first required year and its succeeding taxable year.

E. *Other issues*

1. Sections 905(c) and 986(a)

Section 3.06 of Notice 2025-72 provides that, for purposes of sections 905(c) and 986(a), a specified foreign income tax would accrue in the first required year, regardless of whether a portion of the specified foreign income tax is allocated to the succeeding taxable year. No comments were received on the application of these provisions to specified foreign income taxes, and the proposed regulations would provide that, for purposes of sections 905(c) and 986(a), the first required year is the year to which a specified foreign income tax relates. The proposed regulations would provide similar treatment to relevant succeeding year taxes for purposes of sections 905(c) and 986(a). *See* proposed § 1.898(c)-1(g).

2. Election Procedures

In general, the proposed regulations would provide that the elections described in parts I.B.2 (specified distributive shares of CFTEs), I.B.3 (relevant succeeding year taxes), I.D.2 (income group specific allocation percentage), and I.D.3 (election to not allocate) of this Explanation of Provisions section would be made by an affected corporation's controlling domestic shareholders for its first required year by attaching a statement to their timely filed (including extensions) Federal income tax returns for the years in which or with which the first required year and the succeeding taxable year end. *See* proposed § 1.898(c)-1(h). The election to allocate relevant succeeding year taxes would be irrevocable. *See* proposed § 1.898(c)-1(h)(1).

The proposed regulations would provide that the elections to treat specified distributive shares as specified foreign income taxes and to use the income group specific allocation percentage may be made on an amended Federal income tax return, and except for the election for allocating relevant succeeding year taxes, all of the elections may be revoked on an amended Federal income tax return. An amended Federal income tax return containing an election or revocation must be duly filed within 24 months of the due date (without regard to extensions) of the original Federal income tax return for the year in which or with which the first required year ends. An amended Federal income tax return for the taxable year in which or with which the affected corporation's succeeding taxable year ends must also be filed if needed to reflect a change in election. Permitting a change in election outside of this period could result in changes in amounts of tax due for taxable years that are no longer open for assessment under section 6501 and would increase the administrative burden of the elections. The Treasury Department and the IRS request comments on these election procedures, including the application of this 24-month limitation.

3. Covered Events

Section 3.05(3) of Notice 2025-72 provides rules that would coordinate the allocation of a specified foreign income tax with the covered event rules in § 1.901-2(f)(5) when an affected corporation is the section 901 taxpayer of a portion of the tax due to the application of those rules. *See* part I.A of this Explanation of Provisions section for a description of the covered event rules. A comment requested additional guidance coordinating the covered event rules with the allocation of specified foreign income taxes. Specifically, the comment recommended that the portion of a specified foreign income tax allocated to the succeeding taxable year be further allocated among persons based on the principles of the covered event rules. The comment suggested that the principles of the covered event rules would apply by treating the income earned in the succeeding taxable year as the income to which the specified foreign income tax relates. The comment described cases with respect to which its recommendation would apply.

The Treasury Department and the IRS are of the view that some of the cases discussed in the comment do not involve specified foreign corporations subject to the transition rule and therefore would exceed the authority granted under section 70352(c) of the OBBBA. In other cases, the mismatch of income and foreign income tax was not caused by the repeal of section 898(c)(2) and would likewise be beyond the scope of the transition rule. Finally, the Treasury Department and the IRS do not consider it appropriate to allocate a section 901 taxpayer's foreign income tax to another person. Thus, the proposed regulations do not adopt this comment and would clarify that a specified foreign corporation is an affected corporation if its first taxable year beginning after November 30, 2025, ends pursuant to section 70352(c) of the OBBBA on the date prescribed by that section, which is the last day of the first required year (within the meaning of section 898(c)(1)) ending after November 30, 2025. *See* proposed § 1.898(c)-1(b) (defining affected corporation).

4. Conforming Amendments

The proposed regulations would include conforming amendments to Treasury regulations that refer to the availability of the one-month deferral election or provide special rules when the one-month deferral election is in effect. *See* proposed §§ 1.163(j)-7(k)(29)(i)(B), 1.441-1(b)(2)(ii)(C), 1.441-2(b)(1)(i), and 1.987-11(c)(3)(ii).

II. *Proposed Regulations Implementing the Section 960(d)(4) Foreign Tax Credit Disallowance*

Section 3.01(2) of Notice 2025-77 provides that section 960(d)(4) would apply to foreign income taxes paid or accrued (or deemed paid under section 960(b)(1)) with respect to a section 959(a) distribution to the extent the PTEP results from a section 951A inclusion of a U.S. shareholder in a taxable year ending after June 28, 2025. Section 3.01(3) of Notice 2025-77 provides that the "section 951A PTEP" group set forth in § 1.960-3(c)(2)(viii) would be divided into two groups: (1) PTEP resulting from section 951A inclusions in taxable years of a U.S. shareholder ending on or before June 28, 2025 (pre-06/29/25 section 951A PTEP), and (2) PTEP resulting from section 951A inclusions in taxable years of a U.S. shareholder ending after June 28, 2025 (post-06/28/25 section 951A PTEP). Section 3.01(4) of Notice 2025-77 provides that no credit under section 901 would be allowed for 10 percent of any foreign income taxes paid or accrued (or deemed paid under section 960(b)(1)) with respect to a section 959(a) distribution of post-06/28/25 section 951A PTEP, and those taxes would be allocated and apportioned to post-06/28/25 section 951A PTEP under § 1.861-20. Section 3.01(5) of Notice 2025-77 provides that similar rules would apply to the "reclassified section 951A PTEP" group set forth in § 1.960-3(c)(2)(iv).

No comments were received on Notice 2025-77, and accordingly, the proposed regulations would include these rules. *See* proposed § 1.960-3(b)(6), (c)(2)(iv) and (v), and (c)(2)(ix) and (x). The Treasury Department and the IRS intend to modify the proposed regulations related to PTEP that were published in the **Federal Regis-**

ter on December 2, 2024, (89 FR 95362) to be consistent with these proposed regulations.

III. *Applicability Dates and Reliance*

The Treasury Department and the IRS expect to finalize the proposed regulations by January 4, 2027. Under section 7805(b)(2), proposed § 1.898(c)-1 is proposed to apply to taxable years of specified foreign corporations beginning after November 30, 2025. *See* proposed § 1.898(c)-1(j). A taxpayer may rely on the proposed regulations regarding section 898(c) for foreign taxes paid or accrued before the date the proposed regulations are published as final regulations in the **Federal Register**, provided the taxpayer applies the proposed regulations regarding section 898(c) in their entirety and in a consistent manner to the first required year and succeeding taxable year of a specified foreign corporation.

Under section 7805(b)(2), proposed § 1.960-3(b)(6) is proposed to apply to foreign income taxes paid or accrued (or deemed paid under section 960(b)(1)) with respect to an amount excluded from gross income under section 959(a) by reason of a section 951A inclusion, to the extent the inclusion occurs in a taxable year of a U.S. shareholder ending after June 28, 2025. The corresponding updates to PTEP groups made by proposed § 1.960-3(c)(2) are proposed to apply to taxable years of foreign corporations ending with or within taxable years of U.S. shareholders ending after June 28, 2025. *See* proposed § 1.960-7(c). A taxpayer may rely on the proposed regulations regarding section 960(d)(4) for taxable years of U.S. shareholders beginning before the date the proposed regulations are published as final regulations in the **Federal Register**, provided the taxpayer follows the proposed regulations regarding section 960(d)(4) in their entirety and in a consistent manner for all applicable taxable years.

Special Analyses

I. *Regulatory Planning and Review — Economic Analysis*

The Office of Management and Budget's Office of Information and Regulatory Analysis has determined that this proposed regulation is not significant and is not subject to review under section 6(b) of Executive Order 12866. Therefore, a regulatory impact assessment is not required.

II. *Paperwork Reduction Act*

The Paperwork Reduction Act of 1995, 44 U.S.C. 3501-3520 (PRA), generally requires that a Federal agency obtain the approval of the OMB before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the OMB.

The collections of information in the proposed regulations include reporting, third-party disclosures, and recordkeeping requirements that are necessary for certain individuals and corporations to determine their foreign tax credit under section 901 and related provisions. These collections will be used by IRS for tax compliance purposes.

With respect to section 898(c), the collections in proposed § 1.898(c)-1(h) would provide procedures for making the elections described in parts I.B.2 (specified distributive shares of CFTEs), I.B.3 (relevant succeeding year taxes), I.D.2 (income group specific allocation percentage), and I.D.3 (election to not allocate) of this Explanation of Provisions section. The respondents would be persons who are controlling domestic shareholders of an affected corporation. Pursuant to proposed § 1.898(c)-1(h), respondents would be required to: (1) attach an election statement to an original or amended Federal income tax return (a reporting requirement), and (2) provide any notices required under § 1.964-1(c)(3)(iii) to the persons known to be domestic shareholders of the affected corporation in its first required year and succeeding taxable year (third-party disclosure and recordkeeping requirements).

For purposes of the PRA, the reporting burden associated with proposed § 1.898(c)-1(h) collection requirements will be reflected in the instructions for Form 5471, "Information Return of U.S. Persons With Respect to Certain Foreign Corporations." This revision will be included within the OMB Control Number 1545-0123 for business filers and will be approved by OMB in accordance with the PRA procedures under 5 CFR 1320.10.

III. *Regulatory Flexibility Act*

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6) (RFA), it is hereby certified that the proposed regulations will not have a significant economic impact on a substantial number of small entities. In general, the proposed regulations would affect U.S. shareholders of foreign corporations, and with respect to proposed § 1.898(c)-1, would affect only U.S. shareholders of foreign corporations that have made the one-month deferral election. The Treasury Department and the IRS do not have adequate data readily available to assess the number of small entities potentially affected by the proposed regulations.

The Treasury Department and the IRS have determined that the proposed regulations will not have a significant economic impact on domestic small business entities. Proposed § 1.898(c)-1 would allow taxpayers to not allocate taxes (*see* part I.D.3 of this Explanation of Provisions section), and therefore, generally would impose neither new requirements nor additional costs on small entities. The only additional costs imposed on a small business entity making an election under proposed § 1.898(c)-1(e)(4) are those associated with the collection of information requirements imposed under proposed § 1.898(c)-1(h). The Treasury Department and the IRS have estimated that the average burden of this collection of information is 1.5 hours per response. The IRS's Research, Applied Analytics, and Statistics division estimates that the appropriate wage rate for taxpayers with less than $25,000,000 in total positive income is between $113.16 and $58.60. Thus, the annual burden from each collection of information requirement for small business entities is at most $169.74, which is a de minimis amount. The proposed regulations regarding section 960(d)(4) would not impose new requirements on small entities but rather would implement the statute by specifying the foreign income taxes with respect to which the foreign tax credit disallowance applies. Accordingly, the proposed regulations are not expected to have a significant economic impact on a substantial number of small entities, and a regulatory flexibility analysis is not required. Notwithstanding this certification, the Treasury Department and the IRS welcome comments on the impact of the proposed regulations on small entities, including the number of small entities that may be impacted and whether that impact would be economically significant.

IV. *Submission to the Small Business Administration*

Pursuant to section 7805(f), the proposed regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

V. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. The proposed regulations do not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

VI. *Executive Order 13132: Federalism*

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. The proposed regulations do not have federalism implications, do not impose substantial direct compliance costs on State and local governments, and do not preempt State law within the meaning of the Executive order.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in the preamble under the **ADDRESSES** heading. In addition to the comments specifically requested in the Explanation of Provisions section, the Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any comments submitted will be made available at *https://www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person who submits electronic or written comments. Requests for a public hearing are encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**.

Statement of Availability of IRS Documents

Any IRS Revenue Procedures, Revenue Rulings, Notices, or other guidance cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *https://www.irs.gov*.

Drafting Information

The principal authors of these regulations are Le Chen and Hayley Rassuchine, Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry for § 1.898(c)-1 in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Section 1.898(c)-1 also issued under Sec. 70352(c), Pub. L. 119-21, 139 Stat. 72.

* * * * *

Par. 2. Section 1.163(j)-7 is amended by revising paragraph (k)(29)(i)(B) to read as follows:

§ 1.163(j)-7 Application of the section 163(j) limitation to foreign corporations and United States shareholders.

* * * * *

(k) * * *

(29) * * *

(i) * * *

(B) If the specified group parent is an applicable CFC, the period ending on the last day of the specified group parent's required year described in section 898(c)(1) and beginning on the first day after the last day of the specified group's immediately preceding specified period.

* * * * *

Par. 3. Section 1.441-1 is amended by revising paragraph (b)(2)(ii)(C) to read as follows:

§ 1.441-1 Period for computation of taxable income.

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(C) *Specified foreign corporations*. A specified foreign corporation (as defined in section 898(b)) may use a taxable year other than its required taxable year if it elects a 52–53–week taxable year that ends with reference to its required taxable year as provided in paragraph (b)(2)(ii)(A) of this section.

* * * * *

Par. 4. Section 1.441-2 is amended by revising the fourth sentence of paragraph (b)(1)(i) to read as follows:

§ 1.441-2 Election of taxable year consisting of 52–53 weeks.

* * * * *

(b) * * *

(1) * * *

(i) * * * Similarly, a newly-formed specified foreign corporation (as defined in section 898(b)) may adopt a 52–53–week taxable year if such year ends with reference to the taxpayer's required taxable year. * * *

* * * * *

Par. 5. Add § 1.898(c)-1 under the undesignated center heading "*Miscellaneous Provisions*" to read as follows:

§ 1.898(c)-1 Allocation of foreign income taxes of specified foreign corporations affected by the repeal of section 898(c)(2).

(a) *Overview.* This section provides rules for allocating certain foreign taxes paid or accrued by a specified foreign corporation that is required to change its first taxable year beginning after November 30, 2025, pursuant to section 70352(c)(1)(C) of Public Law 119-21, 139 Stat. 72 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA). Paragraph (b) of this section provides definitions for purposes of this section. Paragraph (c) of this section generally identifies which foreign taxes of an affected corporation are allocated between the affected corporation's first required year and its succeeding taxable year. Paragraph (d) of this section provides ordering rules for allocating a specified foreign income tax under this section. Paragraph (e) of this section provides allocation methods for purposes of determining the amount of a specified foreign income tax allocated to the first required year and the succeeding taxable year and an election to not allocate specified foreign income taxes. Paragraph (f) of this section provides an election to allocate relevant succeeding year taxes between an affected corporation's first required year and its succeeding taxable year. Paragraph (g) of this section provides rules for the treatment of specified foreign income taxes and relevant succeeding year taxes under sections 905(c) and 986(a). Paragraph (h) of this section provides procedures for making the elections provided under paragraphs (c)(2), (e)(3) and (4), and (f) of this section. Paragraph (i) of this section provides examples illustrating the application of this section. Paragraph (j) of this section provides the applicability date.

(b) *Definitions*. The following definitions apply for purposes of this section.

Affected corporation means a specified foreign corporation (as defined in section 898(b)) that takes into account foreign income taxes under an accrual method of accounting and whose first taxable year beginning after November 30, 2025, ends pursuant to section 70352(c) of the OBBBA on the date prescribed by that section.

Affected partnership means a partnership that takes into account foreign income taxes under an accrual method of accounting and whose first taxable year beginning after November 30, 2025, is required to change due to one or more of its partners changing their first taxable year as required by section 70352(c) of the OBBBA.

Allocation percentage has the meaning set forth in paragraph (e)(1) of this section.

Creditable foreign tax expenditure (CFTE) has the meaning set forth in § 1.704-1(b)(4)(viii).

First required year means, with respect to an affected corporation or affected partnership, the first taxable year beginning after November 30, 2025.

Foreign net income tax means a foreign income tax (as defined in § 1.901-2(a)) that is computed based on items of income, gain, deduction, and loss that arise in a foreign taxable year.

Income group specific allocation percentage has the meaning set forth in paragraph (e)(3) of this section.

Relevant succeeding year tax has the meaning set forth in paragraph (f)(1) of this section.

Section 901 taxpayer means the taxpayer described in § 1.901-2(f).

Specified distributive share of a CFTE has the meaning set forth in paragraph (c)(2) of this section.

Specified foreign income tax has the meaning set forth in paragraph (c)(1) of this section.

Succeeding taxable year means, with respect to an affected corporation or affected partnership, the taxable year immediately following the first required year.

United States shareholder has the meaning provided in section 951(b).

(c) *Specified foreign income taxes*—(1) *In general*. Except as provided in paragraph (e)(4) of this section, specified foreign income taxes are allocated between an affected corporation's first required year and its succeeding taxable year under this section. A specified foreign income tax is a foreign net income tax accrued without regard to this section by an affected corporation in its first required year for which the affected corporation is the section 901 taxpayer.

(2) *Election to allocate specified distributive shares of CFTEs*. An election may be made under this paragraph (c)(2) pursuant to the procedures of paragraph (h) of this section. If an election is in effect under this paragraph (c)(2), all specified distributive shares of CFTEs of an affected corporation are treated as specified foreign income taxes. A specified distributive share of a CFTE is an affected corporation's distributive share of a CFTE of an affected partnership if—

(i) The affected corporation takes into account its distributive share of the CFTE in its first required year;

(ii) The CFTE is a foreign net income tax; and

(iii) The affected partnership's first required year ends at the same time as the affected corporation's first required year.

(d) *Ordering rules*. The following ordering rules apply for allocating an affected corporation's specified foreign income taxes between the affected corporation's first required year and its succeeding taxable year.

(1) First, specified foreign income taxes are determined.

(2) Second, each specified foreign income tax is allocated and apportioned to income groups pursuant to the rules in this paragraph (d)(2). Section 1.861-

20, as modified by § 1.960-1(d)(3)(ii)(B), is applied in the first required year to allocate and apportion the specified foreign income tax to the income groups described in § 1.960-1(d)(2) and the PTEP groups treated as income groups under § 1.960-1(d)(3)(ii)(B) in that year, except that the tentative gross tested income items described in § 1.951A-2(c)(7)(ii) are treated as income groups described in § 1.960-1(d)(2)(ii)(C). Whether any item meets the high-tax exception to foreign base company income in § 1.954-1(d) (high-tax exception) or the high-tax exclusion from tested income in § 1.951A-2(c)(7) (high-tax exclusion) in either the first required year or the succeeding taxable year is determined under paragraph (d)(4) of this section.

(3) Third, the allocation method provided in paragraph (e) of this section is applied to determine the amount of specified foreign income tax in each income group that is allocated to the first required year and the succeeding taxable year.

(4) Fourth, for all purposes of the Internal Revenue Code, except for sections 905(c) and 986(a), the amounts of a specified foreign income tax (assigned to the income groups determined under paragraph (d)(2) of this section) that are allocated to the first required year and the succeeding taxable year under paragraph (d)(3) of this section are treated as accruing in each respective year. Thus, for example, the amounts of a specified foreign income tax allocated to the first required year and the succeeding taxable year accrue in each respective year for purposes of computing the affected corporation's items of subpart F income and tested income under sections 952 and 951A (including whether any item meets the high-tax exception or the high-tax exclusion), earnings and profits, and taxes deemed paid under section 960(a), (b), or (d). The amount of a specified foreign income tax allocated to the succeeding taxable year is treated as accruing on the first day of the succeeding taxable year and is not allocated among, and considered paid by, two or more persons under § 1.901-2(f) by reason of events that occur in the succeeding taxable year.

(e) *Allocation method*—(1) *In general*. Subject to the special rules provided in paragraph (e)(2) of this section and the elections described in paragraphs (e)(3) and (4) of this section, the amount of a specified foreign income tax assigned to each income group allocated to the first required year is the specified foreign income tax assigned to that income group multiplied by a fraction (the allocation percentage), the numerator of which is the portion of taxable income, as determined under foreign law, that is attributable to the first required year under the principles of § 1.1502-76(b), and the denominator of which is the total taxable income, as determined under foreign law, for the foreign taxable year with respect to which the specified foreign income tax is imposed. The amount of a specified foreign income tax assigned to each income group remaining after the application of the preceding sentence is allocated to the succeeding taxable year.

(2) *Special rules*—(i) *Allocation method for PTEP groups*. The amount of a specified foreign income tax assigned to a PTEP group under paragraph (d)(2) of this section is allocated to the first required year. The numerator and the denominator of the allocation percentage are adjusted to exclude the foreign law taxable income on which that amount of specified foreign income tax is imposed.

(ii) *Allocation method in the case of certain covered events*. If an affected corporation is the section 901 taxpayer of a portion of a specified foreign income tax by reason of the application of § 1.901-2(f)(5), then the allocation percentage is adjusted as follows—

(A) In the case of an affected corporation whose period of existence or ownership (as determined under § 1.901-2(f)(5)) begins on or before the start of the first required year, the denominator of the allocation percentage is the total foreign law taxable income attributable to the affected corporation's period of existence or ownership (as determined under § 1.901-2(f)(5)).

(B) In the case of an affected corporation whose period of ownership (as determined under § 1.901-2(f)(5)) begins after the start of the first required year, the allocation percentage is deemed to be 100 percent.

(3) *Election to apply income group specific allocation method*. An election may be made under this paragraph (e)(3) pursuant to the procedures of paragraph (h) of this section. If an election is in effect under this paragraph (e)(3), the amount of a specified foreign income tax assigned to each income group allocated to the affected corporation's first required year is the amount of specified foreign income tax assigned to that income group multiplied by a fraction (the income group specific allocation percentage), the numerator of which is the portion of foreign taxable income assigned under § 1.861-20 to the income group that is attributable to the first required year under the principles of § 1.1502-76(b) (using the closing of the books method described in § 1.1502-76(b)(2)(i)), and the denominator of which is the total foreign taxable income assigned under § 1.861-20 to the income group. Adjustments similar to the adjustments provided by paragraph (e)(2) of this section are made in the computation of the income group specific allocation percentage. The amount of specified foreign income tax assigned to each income group remaining after the application of the preceding sentences is allocated to the succeeding taxable year.

(4) *Election to not allocate specified foreign income taxes*. An election may be made under this paragraph (e)(4) pursuant to the procedures of paragraph (h) of this section. If an election is in effect under this paragraph (e)(4), the specified foreign income taxes of an affected corporation are taken into account in the affected corporation's first required year, and the affected corporation's relevant succeeding year taxes cannot be allocated under paragraph (f) of this section.

(f) *Election to allocate relevant succeeding year taxes*—(1) *In general*. An election may be made under this paragraph (f) pursuant to the procedures of paragraph (h) of this section. If an election is in effect under this paragraph (f), the relevant succeeding year taxes of an affected corporation are allocated between the affected corporation's first required year and its succeeding taxable year under this paragraph (f). A relevant succeeding year tax is a foreign net income tax accrued without regard to this section by the affected corporation in its succeeding taxable year for which the affected corporation is the section 901 taxpayer but only if the foreign taxable year with respect to which the tax is imposed begins before the first day of the affected corporation's succeeding taxable year. If the affected corporation is the section 901 taxpayer of a portion of a foreign net income tax by reason of the application of § 1.901-2(f)(5), then the foreign net income tax is a relevant succeeding year tax only if the affected corporation's period of ownership begins before the beginning of its succeeding taxable year. A relevant succeeding year tax includes an affected corporation's distributive share of a CFTE from an affected partnership that the affected corporation takes into account in its succeeding taxable year if the requirements of paragraphs (c)(2)(ii) and (iii) of this section are met and the foreign taxable year with respect to which the CFTE is imposed begins before the first day of the partnership's succeeding taxable year.

(2) *Ordering rules*. The ordering rules described in paragraph (d) of this section apply for allocating a relevant succeeding year tax between an affected corporation's first required year and its succeeding taxable year, except that in applying paragraph (d)(2) of this section, a relevant succeeding year tax is allocated and apportioned to income groups in the succeeding taxable year. A relevant succeeding year tax assigned to a PTEP group under paragraph (d)(2) of this section is allocated to the succeeding taxable year. The amount of a relevant succeeding year tax allocated to the first required year is treated as accruing on the last day of the affected corporation's first required year and is not allocated to and among, and therefore, not considered paid by, two or more persons under § 1.901-2(f) by reason of events that occur in the first required year.

(3) *Allocation method*. The income group specific allocation method described in paragraph (e)(3) of this section applies to determine the amount of a relevant succeeding year tax assigned to each income group allocated between an affected corporation's first required year and its succeeding taxable year.

(g) *Application of sections 905(c) and 986(a)*. For purposes of sections 905(c) and 986(a), a specified foreign income tax accrues in the first required year, and a relevant succeeding year tax accrues in the succeeding taxable year, regardless of the allocation of the tax under this section. Therefore, for purposes of sections 905(c) and 986(a), the first required year is the year to which a specified foreign income tax relates, and the succeeding taxable year is the year to which a relevant succeeding year tax relates. Thus, for example, any change in the liability for a specified foreign income tax results in the following. First, the amount of the specified foreign income tax accrued (without regard to the application of this section) in the first required year is adjusted to reflect the change in liability. Second, the ordering rules of paragraphs (d)(1) through (3) of this section are applied based upon the adjusted amount of the specified foreign income tax. Third, paragraph (d)(4) of this section applies to the adjusted amounts of specified foreign income tax that are treated as accruing in the first required year and the succeeding taxable year by reason of the reapplication of paragraphs (d)(1) through (3) of this section.

(h) *Election procedures*. This paragraph (h) provides rules for making and revoking the elections described in paragraphs (c)(2), (e)(3) and (4), and (f) of this section.

(1) *Persons making the election*. An election is made by the controlling domestic shareholders (as defined in § 1.964-1(c)(5)) of the affected corporation for its first required year. An election made under paragraph (f) of this section is irrevocable.

(2) *Consistency requirement*. If an election is made with respect to an affected corporation, then the election applies to all United States shareholders of the affected corporation for its first required year and its succeeding taxable year.

(3) *Manner*—(i) *In general*. An election under paragraph (c)(2), (e)(3) or (4), or (f) of this section must be made in accordance with this paragraph (h)(3), and as the Secretary of the Treasury or the Secretary's delegate may provide in forms, instructions, publications, or other guidance.

(A) *Election statement requirement*. The controlling domestic shareholders must file the statement required under § 1.964-1(c)(3)(ii) with their timely filed (including extensions) original Federal income tax returns, or in the case of an election under paragraph (c)(2) or (e)(3) of this section, with their amended Federal income tax returns in accordance with paragraph (h)(3)(ii) of this section, for the taxable years of the controlling domestic shareholders in which or with which the affected corporation's first required year and succeeding taxable year end. The statement must be attached to the Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations*, filed with respect to the affected corporation and titled as follows:

(*1*) "Section 898 Specified Distributive Shares of CFTEs Election Statement" for an election under paragraph (c)(2) of this section;

(*2*) "Section 898 Income Group Specific Election Statement" for an election under paragraph (e)(3) of this section;

(*3*) "Section 898 Non-Allocation Election Statement" for an election under paragraph (e)(4) of this section; and

(*4*) "Section 898 Relevant Succeeding Year Tax Election Statement" for an election made under paragraph (f) of this section.

(B) *Notice requirement*. The controlling domestic shareholders making an election must provide any notices required under § 1.964-1(c)(3)(iii). For this purpose, a domestic shareholder under § 1.964-1(c)(3)(iii) includes any person known to be a domestic shareholder in the succeeding taxable year.

(ii) *Election (or revocation) with an amended Federal income tax return*. In the case of an election under paragraph (c)(2) or (e)(3) of this section, or a revocation of an election under paragraph (c)(2), (e)(3) or (4) of this section, made with an amended Federal income tax return—

(A) The election (or revocation) must be made on an amended Federal income tax return duly filed within 24 months of the due date (without regard to extensions) of the original Federal income tax return for the taxable year of each controlling domestic shareholder with or within which the affected corporation's first required year ends; and

(B) If a Federal income tax return for the taxable year of any controlling domestic shareholder with or within which the affected corporation's succeeding taxable year ends has already been filed, an amended Federal income tax return for that year must be filed consistent with the election or revocation of the election.

(i) *Examples*. The following examples illustrate the application of this section.

(1) *Assumed facts*. For purposes of the examples in this paragraph (i), unless otherwise indicated, the following facts are assumed:

(i) CFCX is a specified foreign corporation.

(ii) CFCX's first required year is from December 1, 2025, to December 31, 2025.

(iii) CFCX's succeeding taxable year is from January 1, 2026, to December 31, 2026.

(iv) CFCX takes into account foreign income taxes under an accrual method of accounting.

(v) The functional currency of all qualified business units is the u, and all foreign income taxes are denominated in the u.

(2) *Example 1: Specified foreign income taxes*—(i) *Facts*. CFCX is subject to tax in Country X on the basis of its items of income, gain, deduction, and loss for its Country X taxable year, and the Country X tax is a foreign income tax within the meaning of § 1.901-2(a). CFCX's Country X taxable year is the calendar year. CFCX accrues Country X tax of 7,200u in its first required year. An election under paragraph (e)(4) of this section is not in effect.

(ii) *Analysis*. The 7,200u of Country X tax is a specified foreign income tax under paragraph (c)(1) of this section because it is a foreign net income tax that is accrued by CFCX, an affected corporation, in CFCX's first required year, and CFCX is the section 901 taxpayer of the tax. Accordingly, the 7,200u of Country X tax is allocated between CFCX's first required year and its succeeding taxable year under this section.

(3*) Example 2: Specified distributive share of CFTEs*—(i) *Facts*—(A) *Partnership W and Partnership Y*. CFCX owns 40 percent and 60 percent interests, respectively, in the profits and capital of two foreign business entities: Partnership W, an entity classified as a partnership for Federal income tax purposes that is organized and operates in Country W, and Partnership Y, an entity classified as a partnership for Federal income tax purposes that is organized and operates in Country Y. The remaining interests (60 percent and 40 percent, respectively) in the profits and capital of Partnership W and Partnership Y are owned by persons unrelated to CFCX. Partnership W and Partnership Y each take into account foreign income taxes under an accrual method of accounting. Partnership W and Partnership Y are subject to tax in their countries on the basis of their items of income, gain, deduction, and loss for their foreign taxable year. The Country W tax and the Country Y tax are foreign income taxes within the meaning of § 1.901-2(a). Each partnership's foreign taxable year is the calendar year. Partnership W's U.S. taxable year has always been the calendar year.

(B) *Distributive shares of CFTEs*. For its U.S. taxable year beginning on January 1, 2025, and ending on December 31, 2025, Partnership W accrues Country W tax of 10,000u. For its first required year ending on December 31, 2025, CFCX's distributive share of the Country W tax is 4,000u. For its taxable years beginning before November 30, 2025, Partnership Y's U.S. taxable year ended on November 30. Under section 706(b), Partnership Y is required to change its first taxable year beginning after November 30, 2025, due to CFCX changing its first taxable year beginning after November 30, 2025, by reason of the repeal of section 898(c)(2). For its U.S. taxable year ending on December 31, 2025, Partnership Y accrues Country Y tax of 10,000u. For its first required year ending on December 31, 2025, CFCX's distributive share of the Country Y tax is 6,000u. An election under paragraph (c)(2) of this section is in effect.

(ii) *Analysis*—(A) *Country W tax*. CFCX's 4,000u distributive share of Country W tax is not allocated between CFCX's first required year and its succeeding taxable year under this section. CFCX's 4,000u distributive share of Country W tax is not a specified distributive share of a CFTE because Partnership W is not an affected partnership as defined in paragraph (b) of this section. Partnership W is not an affected partnership because Partnership W was not required to change its taxable year under section 706(b) due to one or more of its partners changing their first taxable year beginning after November 30, 2025, by reason of the repeal of section 898(c)(2). Accordingly, even though an election is in effect under paragraph (c)(2) of this section, CFCX's 4,000u distributive share of the Country W tax is not treated as a specified foreign income tax. Therefore, CFCX's 4,000u distributive share of the Country W tax is not allocated under this section and continues to be taken into account in CFCX's first required year.

(B) *Country Y tax*. CFCX's 6,000u distributive share of Country Y tax is allocated between CFCX's first required year and its succeeding taxable year under the rules of this section because it is a specified distributive share of a CFTE, and an election is in effect under paragraph (c)(2) of this section. Partnership Y is an affected partnership under paragraph (b) of this section because it takes into account foreign income taxes under an accrual method of accounting and is required to change its taxable year under section 706(b) due to its partners changing their first taxable year beginning after November 30, 2025, by reason of the repeal of section 898(c)(2). Further, the Country Y tax is a foreign net income tax, CFCX takes into account its distributive share of the Country Y tax in its first required year, and Partnership Y's first required year ends at the same time (December 31, 2025) as CFCX's first required year.

(4) *Example 3: Allocation of relevant succeeding year taxes*—(i) *Facts*. The facts are the same as in paragraph (i)(2)(i) of this section (*Example 1*), except as follows. CFCX accrues 6,000u of Country X tax in its Country X taxable year beginning on January 1, 2026, and ending on December 31, 2026. CFCX also wholly owns DEZ, a disregarded entity that is organized and operated in Country Z. DEZ is subject to tax in Country Z on the basis of its items of income, gain, deduction, and loss for its Country Z taxable year, and the Country Z tax is a foreign income tax within the meaning of § 1.901-2(a). DEZ's Country Z taxable year begins on April 1, 2025, and ends on March 31, 2026. CFCX accrues 5,000u of Country Z tax in its succeeding taxable year. An election is in effect under paragraph (f) of this section.

(ii) *Analysis*. Because an election is in effect under paragraph (f) of this section, the relevant succeeding year taxes of CFCX are allocated between its first required year and its succeeding taxable year. The 6,000u of Country X tax is not a relevant succeeding year tax under paragraph (f)(1) of this section because the Country X taxable year with respect to which the tax is imposed did not begin before January 1, 2026. The 5,000u of Country Z tax is a relevant succeeding year tax under paragraph (f)(1) of this section because it is a foreign net income tax accrued in CFCX's succeeding taxable year, for which CFCX is the section 901 taxpayer, and the Country Z taxable year with respect to which the 5,000u of Country Z tax is imposed began before January 1, 2026. Accordingly, the 5,000u of Country Z tax is allocated between CFCX's first required year and its succeeding taxable year under paragraph (f) of this section.

(5) *Example 4: § 1.901-2(f)(5) and relevant succeeding year taxes*—(i) *Facts*. The facts are the same as in paragraph (i)(4)(i) of this section (*Example 3*) except as follows. CFCX acquires the interests in DEZ on February 1, 2026. Applying the principles of § 1.1502-76(b), and using the ratable allocation method under § 1.1502-76(b), CFCX is allocated and is treated as paying under § 1.901-2(f)(5), 833u (5,000u x (2 months of foreign law taxable income over 12 months of foreign law taxable income)) of the Country Z tax that accrues on March 31, 2026.

(ii) *Analysis*. The 833u of Country Z tax is not a relevant succeeding year tax. While the Country Z taxable year began before January 1, 2026, CFCX's period of ownership of DEZ did not begin before January 1, 2026. Therefore, no portion of the 833u of Country Z tax is allocated to CFCX's first required year.

(6) *Example 5: Application of § 1.861-20 and allocation of specified foreign income tax*—(i) *Facts*. The facts are the same as in paragraph (i)(2)(i) of this section (*Example 1*). In addition, CFCX's total taxable income under Country X law for the Country X taxable year ending on December 31, 2025, is 45,000u. Applying the principles of § 1.1502-76(b), 3,750u of this income is attributable to CFCX's first required year. Under § 1.861-20, the 7,200u of Country X tax is allocated and apportioned to the income groups under paragraph (d)(2) of this section as follows: 5,400u to general category tentative gross tested income attributable to the CFC tested unit (CFC income group) and 1,800u to the general category foreign base company services income group (FBCServ income group).

(ii) *Analysis*. Pursuant to the ordering rules in paragraph (d) of this section, the 7,200u of Country X tax is allocated and apportioned to the income groups under paragraph (d)(2) of this section before applying the allocation method under paragraph (e)(1) of this section to determine the amount of the Country X tax that is allocated to CFCX's first required year and succeeding taxable year under paragraph (d)(3) of this section. The allocation method applies as follows. The amount of CFCX's taxable income under Country X law that is attributable to the first required year (3,750u) is divided by the total taxable income for the Country X taxable year (45,000u), which results in an allocation percentage of 8.33 percent. The amount of Country X tax in each income group that is allocated to the first required year is determined by applying the allocation percentage to the amount of the specified foreign income tax in each income group. Therefore, the following amounts of the Country X tax are allocated to the first required year: 450u, which is assigned to the CFC income group (8.33 percent of 5,400u); and 150u, which is assigned to the FBCServ income group (8.33 percent of 1,800u). The remaining amount of Country X tax in each income group is allocated to CFCX's succeeding taxable year as follows: 4,950u, assigned to the CFC income group (5,400u-450u) and 1,650u, assigned to the FBCServ income group (1,800u-150u).

(7) *Example 6: Income group specific allocation method*—(i) *Facts*. The facts are the same as in paragraph (i)(6)(i) of this section (*Example 5*), except as follows. An election is made under paragraph (e)(3) of this section to use the income group specific allocation method. In applying § 1.861-20 under paragraph (d)(2) of this section, 33,750u of CFCX's taxable income under Country X law is assigned to the CFC income group, and 11,250u of CFCX's taxable income under Country X law is assigned to the FBCServ income group. Applying the principles of § 1.1502-76(b) and using a closing of the books method under § 1.1502-76(b) to the items of Country X income, gain, deduction, and loss assigned to each income group, 2,250u of CFCX's Country X taxable income assigned to the CFC income group is attributable to the first required year, and 1,125u of CFCX's Country X taxable income assigned to the FBCServ income group is attributable to the first required year.

(ii) *Analysis*—(A) *Tax assigned to the CFC income group*. The income group specific allocation method applies as follows. Under § 1.861-20, 5,400u of the Country X tax is assigned to the CFC income group. The amount of CFCX's Country X taxable income assigned to the CFC income group that is attributable to the first required year (2,250u) is divided by CFCX's total Country X taxable income assigned to that income group for the Country X taxable year (33,750u), which results in an income group specific allocation percentage of 6.66 percent. Therefore, 360u of Country X tax assigned to the CFC income group is allocated to the first required year. The remaining amount of Country X tax assigned to the CFC income group (5,040u) is allocated to the succeeding taxable year.

(B) *Tax assigned to the FBCServ income group*. Under § 1.861-20, 1,800u of Country X tax is assigned to the FBCServ income group. The amount of CFCX's Country X taxable income assigned to this income group that is attributed to the first required year (1,125u) is divided by CFCX's total Country X taxable income assigned to that income group for the Country X taxable year (11,250u), which results in an income group specific allocation percentage of 10 percent. Therefore, 180u of Country X tax assigned to the FBCServ income group is allocated to the first required year. The remaining amount of Country X tax assigned to the FBCServ income group (1,620u) is allocated to the succeeding taxable year.

(8) *Example 7: Application of the high-tax exclusion*—(i) *Facts*. The facts are the same as in paragraph (i)(7)(i) of this section (*Example 6*), except as follows. An election under § 1.951A-2(c)(7)(viii) is in effect with respect to CFCX for the first required year. Under § 1.951A-2(c)(7)(ii), CFCX has two tentative gross tested income items: 3,000u in the CFC income group and 2,000u of general category tentative gross tested income attributable to the DEZ tested unit. CFCX accrues no expenses in its first required year other than the specified foreign income tax.

(ii) *Analysis*. Under paragraph (d)(4) of this section, the portion of the Country X tax allocated to the first required year is treated as the amount of Country X tax accrued in that taxable year for all purposes of the Code except sections 905(c) and 986(a). Therefore, in determining whether any of CFCX's tentative gross tested income items meet the high-tax exclusion, 360u of Country X tax is treated as accrued in the first required year and allocated and apportioned to the CFC income group, the statutory grouping to which 3,000u of gross income is assigned. If an election under § 1.951A-2(c)(7)(viii) is in effect with respect to CFCX for the succeeding taxable year, the 5,040u of Country X tax assigned to the CFC income group would be taken into account in the same manner in that year.

(j) *Applicability date*. This section applies to taxable years of specified foreign corporations beginning after November 30, 2025.

Par. 6. Section 1.901-1 is amended by revising paragraph (b) to read as follows:

§ 1.901-1 Allowance of credit for foreign income taxes.

* * * * *

(b) *Limitations*. Certain Code sections, including sections 245A(d) and (e)(3), 814, 901(e) through (m), 904, 906 through 909, 911, 960(d)(4), 965(g), 999, and 6038, reduce, defer, or otherwise limit the credit against the tax imposed by chapter 1 of the Code for certain amounts of foreign income taxes.

* * * * *

Par. 7. Section 1.960-3 is amended by:

1. Revising the section heading;
2. Revising the first sentence of paragraph (a);
3. Revising the heading of paragraph (b) and the second sentence of paragraph (b)(1);
4. Adding paragraph (b)(6);
5. In paragraph (c)(2)(iii)(B), removing the language "paragraphs (c)(2)(vi) through (ix)" and adding "paragraphs (c)(2)(vii) through (xi)" in its place;
6. Revising paragraph (c)(2)(iv);
7. Redesignating paragraphs (c)(2)(v), (c)(2)(vi), (c)(2)(vii), (c)(2)(viii), (c)(2)(ix), and (c)(2)(x) as paragraphs (c)(2)(vi), (c)(2)(vii), (c)(2)(viii), (c)(2)(ix), (c)(2)(xi), and (c)(2)(xii), respectively, and adding new paragraph (c)(2)(v);
8. In newly redesignated paragraph (c)(2)(vi), removing the language "paragraphs (c)(2)(v)(A)" and adding "paragraphs (c)(2)(vi)(A)" in its place;
9. Revising newly redesignated paragraph (c)(2)(ix);
10. Adding new paragraph (c)(2)(x);
11. In newly redesignated paragraph (c)(2)(xi), removing the language "paragraphs (c)(2)(ix)(A)" and adding "paragraphs (c)(2)(xi)(A)" in its place;
12. In newly redesignated paragraph (c)(2)(xii), removing the language "paragraph (c)(2)(vi) through (ix)" and adding "paragraph (c)(2)(vii) through (xi)" in its place;
13. In paragraph (e)(2), removing the language "section 951A PTEP" wherever it appears and adding "pre-06/29/25 section 951A PTEP" in its place; and
14. Adding paragraphs (e)(3) and (4).

The revisions and additions read as follows:

§ 1.960-3 Foreign income taxes deemed paid under section 960(b) and foreign tax credits disallowed under section 960(d)(4).

(a) * * * Paragraph (b) of this section provides rules for computing the amount of foreign income taxes deemed paid by a domestic corporation that is a United States shareholder of a controlled foreign corporation, or by a controlled foreign corporation, under section 960(b), and for determining the foreign income taxes subject to the credit disallowance under section 960(d)(4). * * *

(b) *Foreign income taxes deemed paid under section 960(b) and foreign tax credits disallowed under section 960(d)(4)*—(1) * * * See paragraph (b)(6) of this section for rules disallowing credits in relation to a distribution of certain previously taxed earnings and profits resulting from the application of section 960(d)(4), and § 1.965-5(c)(1)(iii) for rules disallowing credits in relation to a distribution of certain previously taxed earnings and profits resulting from the application of section 965. * * *

* * * * *

(6) *Foreign tax credits disallowed under section 960(d)(4)*—(i) *In general.*

No credit under section 901 is allowed for 10 percent of—

(A) Foreign income taxes attributable to a section 959(a) distribution of post-06/28/25 section 951A PTEP (as defined in paragraph (c)(2)(ix) of this section) or reclassified post-06/28/25 section 951A PTEP (as defined in paragraph (c)(2)(iv) of this section); and

(B) Foreign income taxes deemed paid under paragraph (b)(1) of this section with respect to a section 959(a) distribution of post-06/28/25 section 951A PTEP (as defined in paragraph (c)(2)(ix) of this section) or reclassified post-06/28/25 section 951A PTEP (as defined in paragraph (c)(2)(iv) of this section).

(ii) *Attribution of foreign income taxes.* For purposes of paragraph (b)(6)(i)(A) of this section, foreign income taxes are attributable to a section 959(a) distribution of post-06/28/25 section 951A PTEP or reclassified post-06/28/25 section 951A PTEP if those taxes would be allocated and apportioned to a distribution of those previously taxed earnings and profits under the rules of § 1.861-20, applied by treating the portion of the distribution that is attributable to post-06/28/25 section 951A PTEP and reclassified post-06/28/25 section 951A PTEP as the statutory groupings, and the portion of the distribution that is attributable to other earnings and profits as the residual grouping.

(c) * * *

(2) * * *

(iv) Earnings and profits described in section 959(c)(1)(A) that were initially described in paragraph (c)(2)(ix) of this section ("reclassified post-06/28/25 section 951A PTEP");

(v) Earnings and profits described in section 959(c)(1)(A) that were initially described in paragraph (c)(2)(x) of this section ("reclassified pre-06/29/25 section 951A PTEP");

* * * * *

(ix) Earnings and profits described in section 959(c)(2) by reason of section 951A, to the extent that the inclusion under section 951A occurs in a taxable year of a United States shareholder ending after June 28, 2025 ("post-06/28/25 section 951A PTEP");

(x) Earnings and profits described in section 959(c)(2) by reason of section 951A, to the extent not described in paragraph (c)(2)(ix) of this section ("pre-06/29/25 section 951A PTEP");

* * * * *

(e) * * *

(3) *Example 3: Foreign tax credits disallowed under section 960(d)(4)*—(i) *Facts.* USP, a domestic corporation, owns all of the stock of a single foreign corporation (FC1). FC1, a Country X entity that is a controlled foreign corporation, has the U.S. dollar as its functional currency. Both FC1 and USP use the calendar year as their taxable year. FC1 does not have any accumulated earnings and profits as of the beginning of its 2024 taxable year. FC1 earns tested income of $100x for each of its 2024 and 2025 taxable years, and USP has an inclusion under section 951A (section 951A inclusion) of $100x in each of its 2024 and 2025 taxable years. FC1 has no items of income, gain, deduction, or loss in any of its subsequent taxable years. On January 1, 2026, FC1 distributes $150x to USP, which is a section 959(a) distribution and is treated as a distribution of property for both Country X law and Federal income tax purposes. Country X imposes a withholding tax (as defined in section 901(k)(1)(B)) of $30x with respect to the section 959(a) distribution. For its 2026 taxable year, USP claims the foreign tax credit under section 901.

(ii) *Analysis*—(A) *PTEP groups.* FC1 has earnings and profits of $100x within the annual PTEP account in the section 951A category for its 2024 taxable year. Under paragraph (c)(2)(x) of this section, the $100x of previously taxed earnings and profits, which results from a section 951A inclusion of USP in a taxable year of USP ending on or before June 28, 2025, constitutes pre-06/29/25 section 951A PTEP. FC1 also has earnings and profits of $100x within the annual PTEP account in the section 951A category for its 2025 taxable year. Under paragraph (c)(2)(ix) of this section, the $100x of previously taxed earnings and profits, which results from a section 951A inclusion of USP in a taxable year of USP ending after June 28, 2025, constitutes post-06/28/25 section 951A PTEP.

(B) *Attribution of foreign income taxes.* Under section 959(c) and § 1.959-3(b), FC1's $150x distribution on January 1, 2026, constitutes a distribution of $100x of FC1's previously taxed earnings and profits for its 2025 taxable year and $50x of FC1's previously taxed earnings and profits for its 2024 taxable year. Under paragraph (b)(6)(ii) of this section and § 1.861-20(d)(3)(i)(B), $100x of the foreign gross income related to the $150x distribution is assigned to the statutory grouping for the portion of the distribution attributable to post-06/28/25 section 951A PTEP, and $50x is assigned to the residual grouping for the portion of the distribution attributable to other earnings and profits. Under paragraph (b)(6)(ii) of this section and § 1.861-20(f), $20x of the $30x of Country X withholding tax ($30x x $100x/$150x) is allocated and apportioned to the statutory grouping, and the remaining $10x ($30x x $50x/$150x) is allocated and apportioned to the residual grouping.

(C) *Disallowance of foreign tax credits.* Under section 960(d)(4) and paragraph (b)(6)(i)(A) of this section, $2x (that is, 10 percent) of the $20x of foreign tax credits otherwise allowable to USP under section 901 with respect to the $20x of Country X withholding tax allocated and apportioned to the statutory grouping is disallowed.

(iii) *Alternative facts—Distribution before June 28, 2025*. The facts are the same as in paragraph (e)(3)(i) of this section, except that the $150x distribution occurs on February 1, 2025. The result is the same as in paragraph (e)(3)(ii) of this section.

(4) *Example 4: Foreign tax credit disallowance under section 960(d)(4) for foreign income taxes deemed paid under section 960(b)*—(i) *Facts*. The facts are the same as in paragraph (e)(3)(i) of this section (*Example 3*), except as follows. FC1 owns all the stock of FC2, a Country Y entity that is a controlled foreign corporation and uses the U.S. dollar as its functional currency. FC2 uses the calendar year as its taxable year. As of January 1, 2027, FC1 does not have any accumulated earnings and profits and FC2's accumulated earnings and profits are entirely comprised of $100x of post-06/28/25 section 951A PTEP within the annual PTEP account in the section 951A category for its 2026 taxable year. On January 1, 2027, FC2 distributes $100x to FC1 (distribution 1), which is treated as a distribution of property for both Country Y law and Federal income tax purposes. Country Y imposes a withholding tax (as defined in section 901(k)(1)(B)) of $20x with respect to distribution 1. FC1 subsequently distributes $80x to USP (distribution 2), which is a section 959(a) distribution. Country X does not impose any withholding tax with respect to distribution 2. Neither FC1 nor FC2 has items of income, gain, deduction, or loss for its 2027 taxable year. For its 2027 taxable year, USP claims the foreign tax credit under section 901.

(ii) *Analysis*—(A) *Distribution 1*. Under section 959(c) and § 1.959-3(b), distribution 1 constitutes a distribution of $100x of FC2's previously taxed earnings and profits. Under paragraph (c)(3) of this section, FC1's post-06/28/25 section 951A PTEP within the annual PTEP account in the section 951A category for its 2026 taxable year is increased by $100x but reduced by the $20x of Country Y withholding tax that is allocated and apportioned to the post-06/28/25 section 951A PTEP under § 1.960-1(d)(3)(ii). FC1's PTEP group taxes with respect to its post-06/28/25 section 951A PTEP within the annual PTEP account in the section 951A category for its 2026 taxable year are increased by $20x under paragraph (d) of this section.

(B) *Distribution 2*. Under section 959(c) and § 1.959-3(b), distribution 2 constitutes a distribution of $80x of FC1's previously taxed earnings and profits. Under paragraph (b)(4) of this section, USP's proportionate share of FC1's PTEP group taxes is $20x. Under section 960(d)(4) and paragraph (b)(6)(i)(B) of this section, $2x (that is, 10 percent) of the $20x of foreign tax credits otherwise allowable to USP under section 901 with respect to FC1's $20x of PTEP group taxes deemed paid by USP under section 960(b)(1) is disallowed.

Par. 8. Section 1.960-7 is amended by:

1. In paragraph (a), removing the language "paragraph (b)" and adding "paragraphs (b) and (c)" in its place; and

2. Adding paragraph (c).

The addition reads as follows:

§ 1.960-7 Applicability dates.

* * * * *

(c) Section 1.960-3(b)(6) applies to foreign income taxes paid or accrued (or deemed paid under section 960(b)(1)) with respect to an amount excluded from gross income under section 959(a) by reason of an inclusion in gross income under section 951A(a), to the extent the inclusion occurs in a taxable year of a United States shareholder ending after June 28, 2025. Section 1.960-3(c)(2) applies to taxable years of foreign corporations ending with or within taxable years of United States shareholders ending after June 28, 2025. For taxable years of foreign corporations ending on or after December 4, 2018, and beginning before the taxable year described in the preceding sentence, *see* § 1.960-3(c)(2) as contained in 26 CFR part 1 revised as of April 1, 2026.

Par. 9. Section 1.987-11 is amended by revising paragraph (c)(3)(ii) to read as follows:

§ 1.987-11 Suspended section 987 loss relating to certain elections; loss-to-the-extent-of-gain rule.

* * * * *

(c) * * *

(3) * * *

(ii) *Owner is a CFC*. For purposes of applying paragraph (c)(2) of this section with respect to an owner that is a CFC, suspended section 987 loss and gross income of a member of the owner's controlled group is determined by reference to the member's suspended section 987 loss and gross income for its taxable year ending with or within the owner's required year described in section 898(c)(1).

* * * * *

Frank J. Bisignano,
Chief Executive Officer.

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Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2026–27 through 2026–52 is in Internal Revenue Bulletin 2025–52, dated December 21, 2025.

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