

## Section 988.—Treatment of Certain Foreign Currency Transactions

26 CFR 1.988-1: Certain definitions and special rules.

T.D. 8914

### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

#### Definition of Hyperinflationary Currency for Purposes of Section 988

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning when a currency will be considered hyperinflationary for purposes of section 988. These final regulations are intended to prevent distortions associated with the computation of income and expense arising from section 988 transactions denominated in hyperinflationary currencies.

DATES: The effective date of this regulation is February 14, 2000.

FOR FURTHER INFORMATION CONTACT: John W. Rogers III of the Office of Associate Chief Counsel (International) at (202) 622-3870.

SUPPLEMENTARY INFORMATION:

#### Background

This document contains final Income Tax Regulations (26 CFR part 1) under section 988 of the Internal Revenue Code (Code). On March 17, 1992, the IRS and Treasury published final regulations (57 F.R. 9172) relating to the taxation of section 988 transactions, including, *inter alia*, transactions denominated in hyperinfla-

tionary currencies. Also on March 17, 1992, proposed regulations were published (57 F.R. 9217) relating to the treatment of certain financial instruments denominated in hyperinflationary currencies. The proposed regulations did not separately define hyperinflationary currency. Rather, they simply made reference to the definition in the final regulations, §1.988-1(f).

T.D. 8860 (2000-5 I.R.B. 437) (65 F.R. 2026) (January 13, 2000) finalized the proposed regulations relating to the treatment of financial instruments denominated in hyperinflationary currencies. Also in that issue of the Bulletin was a notice of proposed rulemaking (REG-116567-99, 2000-5 I.R.B. 463) regarding a proposed change in the period of years that are considered in determining whether a currency is hyperinflationary for purposes of section 988 (base period). The notice of proposed rulemaking also provided notice of a public hearing on the proposed regulations. No requests to speak were received, and the public hearing was canceled. This Treasury decision finalizes the proposed regulations relating to the change in base period, with certain minor changes.

#### Explanation of Provisions

As set out in the notice of proposed rulemaking, the term hyperinflationary currency, as defined in §1.988-1(f), utilizes the definition in §1.985-1(b)(2)(ii)(D). This definition was developed in the context of the Dollar Approximate Separate Transactions Method (DASTM) regulations, §1.985-3, and generally considers the cumulative effects of inflation over the base period in determining whether a currency is hyperinflationary. In §1.985-1(b)(2)(ii)(D), the base period consists of the thirty-six calendar month period immediately preceding the first day of the current calendar year. Use of this base period is generally appropriate in the context of DASTM because a qualified business unit needs to know in advance if it is subject to §1.985-3 calculations.

However, failure to take the current year's inflation into account for purposes of computing foreign currency gain or loss under section 988 may lead to distortions in income and expense because inflation may rise dramatically in a single

year. Accordingly, the IRS and Treasury believe that for purposes of section 988, it is more appropriate to consider the cumulative inflation rate over the thirty-six month period ending on the last day of the taxpayer's (or the qualified business unit's) current taxable year. This change in the base period, however, applies only for the purposes of section 988 and not for the purpose of determining whether a taxpayer (or QBU) is subject to the provisions of §1.985-3.

#### Summary of Comments

One comment was received in connection with the proposed change in the measurement of the base period under section 988. This comment relates to the application of the rule to regulated investment companies (RICs). The commenter stated that sections 852(a) and 4982 effectively require a RIC to distribute essentially all of its income during the calendar year in which it is earned. Thus, the commenter concluded that RICs need to know before the end of their tax year whether a particular currency is hyperinflationary. The Treasury and IRS recognize that the revised definition of base period could present an administrative burden for RICs. Accordingly, the final regulation provides that RICs are not subject to the revised base period standard of these final regulations.

A similar exclusion from the revised base period standard has been made for REITs due to their similar distribution requirements. The regulation has also been amended to provide that the Service may by notice provide that the revised base period standard shall not apply to any section 988 transaction of an entity with distribution requirements similar to that of RICs and REITs.

In addition, the regulation was amended to provide that generally accepted accounting principles may not apply to alter the base period outlined in paragraph (f)(1)(ii)(A) of this section. This change is intended to clarify that the last sentence of §1.985-1(b)(2)(ii)(D) may not be used to alter the base period for purposes of section 988.

#### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive

Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required.

### Drafting Information

The principal author of these regulations is John W. Rogers III of the Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department also participated in their development.

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### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended 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. In §1.988-1, paragraph (f) is revised to read as follows:

#### §1.988-1 *Certain definitions and special rules*

\* \* \* \* \*

(f) *Hyperinflationary currency*—(1) *Definition*—(i) *General rule*. For purposes of section 988, a hyperinflationary currency means a currency described in §1.985-1(b)(2)(ii)(D). Unless otherwise provided, the currency in any example used in §§1.988-1 through 1.988-5 is not a hyperinflationary currency.

(ii) *Special rules for determining base period*. In determining whether a currency is hyperinflationary under §1.985-1(b)(2)(ii)(D) for purposes of this paragraph (f), the following rules will apply:

(A) The base period means the thirty-six calendar month period ending on the last day of the taxpayer's (or qualified business unit's) current taxable year. Thus, for example, if for 1996, 1997, and 1998, a country's annual inflation rates are 6 percent, 11 percent, and 90 percent, respectively, the cumulative inflation rate for the three-year base period is 124%  $(((1.06 \times 1.11 \times 1.90) - 1.0 = 1.24) \times 100$

$= 124\%$ ). Accordingly, assuming the QBU has a calendar year as its taxable year, the currency of the country is hyperinflationary for the 1998 taxable year. This change in the §1.985-1(b)(2)(ii)(D) base period shall not apply to any section 988 transaction of an entity described in section 851 (regulated investment company (RIC)) or section 856 (real estate investment trust (REIT)). The Service may, by notice, provide that the foregoing change in the §1.985-1(b)(2)(ii)(D) base period does not apply to any section 988 transaction of an entity with distribution requirements similar to a RIC or REIT.

(B) The last sentence of §1.985-1(b)(2)(ii)(D) shall not apply to alter the base period for purposes of this paragraph (f) in determining whether a currency is hyperinflationary for purposes of section 988. Accordingly, generally accepted accounting principles may not apply to alter the base period for purposes of this paragraph (f). (2) *Effective date*. Paragraph (f)(1) of this section shall apply to transactions entered into after February 14, 2000.

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Robert E. Wenzel,  
*Deputy Commissioner  
of Internal Revenue.*

Approved November 29, 2000.

Jonathan Talisman,  
*Acting Assistant Secretary  
of the Treasury.*

(Filed by the Office of the Federal Register on December 29, 2000, 8:45 a.m., and published in the issue of the Federal Register for January 3, 2001, 66 F.R. 279)