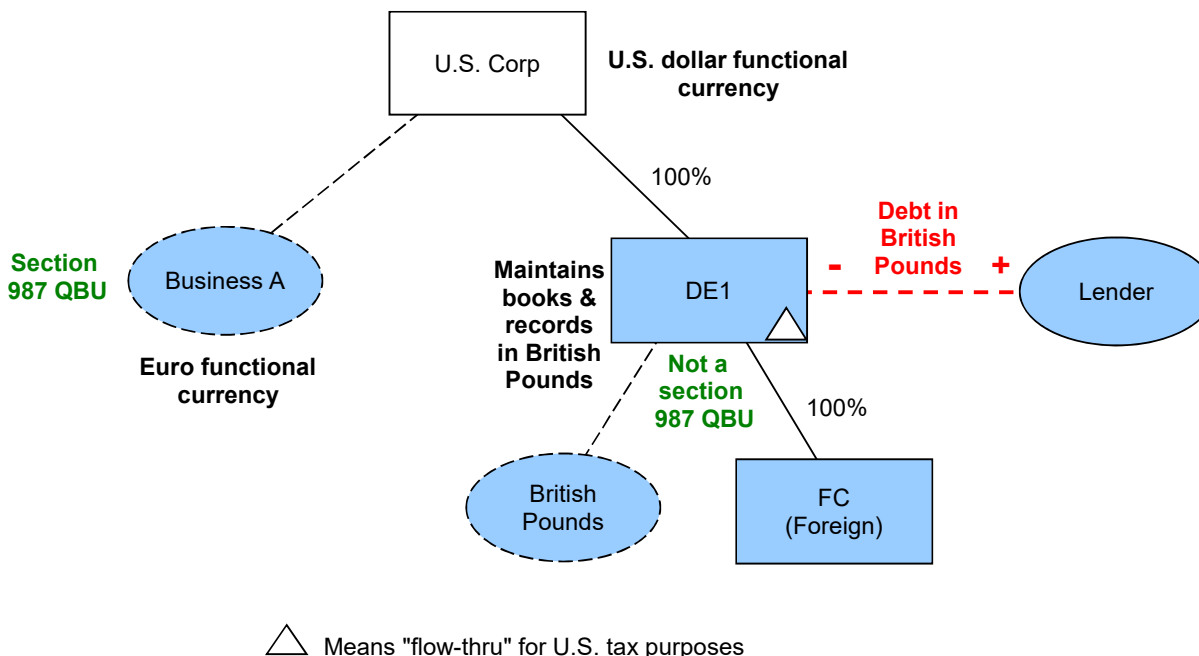


Reg. 1.987-1(b)(7), Ex. 1

Not a Section 987 QBU: Disregarded Entity Holding Stock & Servicing a Debt

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U.S. Corp is a domestic corporation, has the U.S. dollar as its functional currency, and uses the calendar year as its taxable year. U.S. Corp owns Business A and all of the interests in DE1, a disregarded entity. DE1 maintains a separate set of books and records that are kept in British pounds. DE1 owns pounds and all of the stock of a foreign corporation, FC. DE1 is liable to a lender on a pound-denominated obligation that was incurred to acquire the stock of FC. The FC stock, the pounds, and the liability incurred to acquire the FC stock are recorded on DE1's separate books and records. DE1 has no other assets or liabilities and conducts no activities (other than holding the FC stock and servicing its liability).



Pursuant to Treas. Reg. §1.987-1(b)(4)(i), U.S. Corp is the direct owner of Business A because it is the owner of the assets and liabilities of Business A. Because Business A is an eligible QBU with a functional currency that is different from the functional currency of its owner, U.S. Corp, Business A is a section 987 QBU (as defined in Treas. Reg. §1.987-1(b)(2)). As a result, U.S. Corp and its section 987 QBU, Business A, are subject to section 987.

Holding the stock of FC and pounds and servicing a liability does not constitute a trade or business within the meaning of Treas. Reg. §1.989(a)-1(c). Because the activities of DE1 do not constitute a trade or business within the meaning of Treas. Reg. §1.989(a)-1(c), such activities are not an eligible QBU. In addition, pursuant to Treas. Reg. 1.987-1(b)(3)(ii), DE1 itself is not an eligible QBU. As a result, neither DE1 nor its activities qualify as a section 987 QBU of U.S. Corp. Therefore, neither the activities of DE1 nor DE1 itself is subject to section 987. For the foreign currency treatment of payments on DE1's pound-denominated liability, see Treas. Reg. §1.988-2(b).

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