

MEMO# 1426

October 9, 1989

FUNCTIONAL CURRENCY REGULATIONS ON QUALIFIED BUSINESS UNIT

October 9, 1989 TO: TAX MEMBERS NO. 37-89 CLOSED-END FUND MEMBERS NO. 51-89
INTERNATIONAL FUNDS TASK FORCE NO. 15-89 ACCOUNTING/TREASURERS COMMITTEE
NO. 43-89 RE: FUNCTIONAL CURRENCY REGULATIONS ON QUALIFIED BUSINESS UNIT

As we previously informed you, last year the Treasury Department published two sets of temporary regulations providing guidance on functional currency issues. (See Institute Memorandum to Tax Members No. 35-88, Closed-End Fund Members No. 33-88 and Accounting/Treasurers Advisory Committee No. 26-88, dated June 27, 1988). These regulations provided guidance with respect to the foreign currency requirements in Code sections 985 through 989 which require generally that all federal income tax determinations be made in a taxpayer's functional currency. The first set of temporary regulations issued last year (under section 985) defined functional currency and provided certain rules for taxpayer elections and methods of accounting. The second set of temporary regulations (issued under section 989) set forth the requirements for a qualified business unit ("QBU"). Under these rules, a QBU is a separate and clearly identified unit of a trade or business of a taxpayer that may, in certain instances, have its own functional currency. The attached recently published regulations finalize the temporary regulations issued last June under section 985 and, in addition, contain new temporary and proposed regulations under section 985 regarding (1) adjustments required upon a change in functional currency, (2) transition rules for a QBU that uses the dollar approximate separate transactions method of accounting, and (3) the definition of weighted average exchange rate. The final regulations resolve one issue not addressed by the earlier temporary regulations. Specifically, an example has been added to illustrate that a domestic regulated investment company ("RIC") "operating exclusively abroad" can have a QBU which has a non-dollar functional currency. In the example, the principal activities of the "branch" of a single-country fund consist of buying and selling stock and securities of the foreign country's companies and the securities issued by the foreign country. Under United States generally accepted accounting principles ("GAAP"), the functional currency of the branch would be the U.S. dollar. The example concludes, however, that since GAAP is not based on facts and circumstances substantially similar to those in these regulations, the branch may choose the foreign country's currency as its functional currency, provided it keeps its books and records in the foreign country's currency. The final regulations, and the removal of the temporary regulations they replace, are effective for all taxable years beginning after October 20, 1989 and may be applied to all taxable years beginning after December 31, 1986. The temporary and proposed regulations published in this set of regulations are effective for all taxable years beginning after December 31, 1986. Written comments and requests for a public hearing with respect to the new temporary and proposed regulations must be submitted to IRS by November 20,

1989. Please contact the undersigned at (202) 955-3585 by November 3, 1989 if you would like the Institute to file comments on these regulations. We will keep you informed of developments. Keith D. Lawson Assistant General Counsel Attachment

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