# Dollar Approximate Separate Transactions Method (DASTM)

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# Agenda

- DASTM Principles
- Applicability of DASTM
- Mechanics of DASTM

# Principles of DASTM

- DASTM is a method of determining profit or loss or E&P in USD, where the taxpayer or QBU otherwise would use a non-USD functional currency. DASTM is drawn from FAS 52.
- Relevant where a QBU otherwise would use a hyperinflationary currency as its functional currency.
- DASTM is necessary because the normal translation rules would not properly reflect the income or loss of the QBU in USD-terms, as the hyperinflationary currency depreciates significantly against other currencies, including the USD. Thus, cost recovery deductions would be relatively small compared to sales in terms of the hyperinflationary currency ("disappearing plant" problem).
- DASTM involves preserving the USD value of such items and more frequent translations of income items from hyperinflationary currency to the USD.
- DASTM gain or loss reflects the effects of the depreciation of the hyperinflationary currency against the USD with respect to certain "current" assets and liabilities.

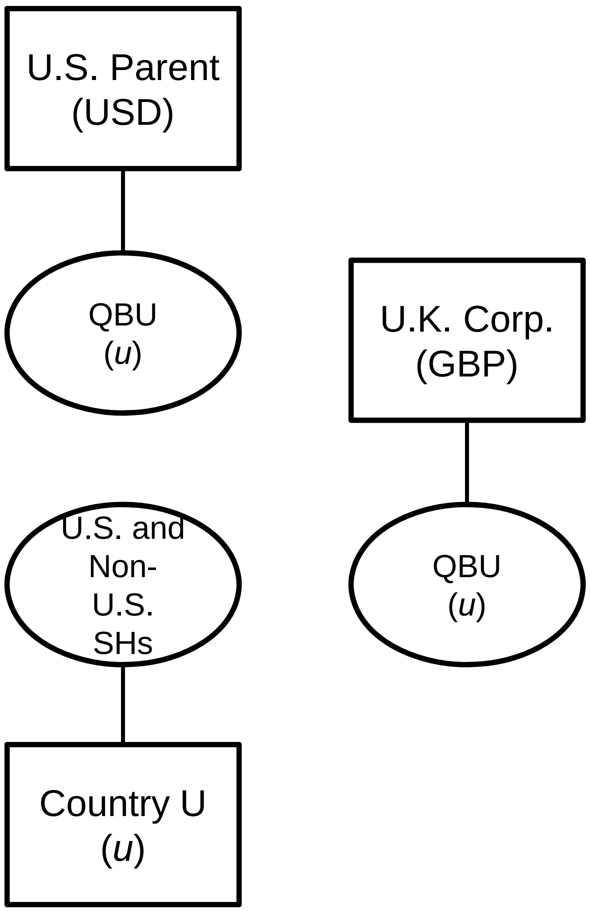
# QBUs Permitted to use USD Functional Currency

- For tax years beginning on or before August 24, 1994, an "eligible QBU" may elect to use the USD as its functional currency in any open year beginning after 1986. § 1.985-2(a)(1).
- An "eligible QBU" is a QBU that could have used a hyperinflationary currency as its functional currency absent a USD functional currency election. § 1.985-2(b)(1).
- If a USD functional currency election is made, the USD must be used as the functional currency of any related person that is itself an eligible QBU and any eligible QBU that is a branch of a related person. § 1.985-2(d)(3)(i).
- If such an election is made, the QBU generally must use DASTM. § 1.985-2(d)(2)(i); § 1.985-3(a)(2)(ii).
- The QBU may use an alternative method, however, if it demonstrates to the satisfaction of the Commissioner that it can properly employ the method and, in particular, that it can compute functional currency gain or loss under the principles of § 988. § 1.985-2(d)(2)(ii).
- If a USD functional currency election is made, the Commissioner is deemed to consent to the change in functional currency. § 1.985-2(d)(4). The adjustments required under § 1.985-5 must be made, but no adjustments are required under § 481. § 1.985-2(d)(4).

# QBUs Required to use USD as Functional Currency

- For tax years beginning after August 24, 1994, subject to two exceptions, any QBU that otherwise would be required to use a hyperinflationary currency as its functional currency must use the USD as its functional currency and compute income or loss or E&P using DASTM. § 1.985-1(b)(2)(ii)(A).
- Exceptions
  - A QBU that (i) is a branch of a foreign corporation having a non-USD functional currency that is not hyperinflationary, and (ii) would be required to use a hyperinflationary currency as its functional currency, is required to use the functional currency of the foreign corporation. § 1.985-1(b)(2)(ii)(B)(1). The QBU must use DASTM, modified by substituting the functional currency of the foreign corporation for the USD. § 1.985-1(b)(2)(ii)(B)(1).
  - A foreign corporation or its QBU branch that operates in a hyperinflationary currency is not required to use the USD as its functional currency if the foreign corporation does not qualify as a CFC. It may, however, elect to use the USD if it qualifies as a non-controlled § 902 corporation (a 10/50 corporation). § 1.985-1(b)(2)(ii)(B)(2).

# QBUs with Hyperinflationary Currency – Examples




- U.S. Parent is a domestic corporation that uses the USD as its functional currency and owns a Country U QBU that would use the *u* as its functional currency. The *u* qualifies as a hyperinflationary currency. Thus, the Country U QBU is required to use the USD as its functional currency.
- Now assume that the Country U QBU is owned by a U.K. company that is classified as a corporation and uses the GBP as its functional currency. The Country U QBU is required to use the GBP as its functional currency, substituting GBP for USD in applying DASTM.
- Finally, assume that there is a Country U company that is classified as a corporation and would use the *u* as its functional currency. Is the Country U corporation required to use the USD as its functional currency?
  - Suppose its only U.S. shareholder owns 5% of its stock?
  - 25%?
  - 67%?

# Hyperinflationary Currency

- The term “hyperinflationary currency” means the currency of a country in which there is cumulative inflation of at least 100% during the 36 calendar months immediately preceding the last day of the preceding taxable year, as determined by reference to the CPI of the country listed in the monthly issues of International Financial Statistics or the successor publication of the IMF. § 1.985-1(b)(2)(ii)(D).
- If a country is not listed, the taxpayer may use any reasonable method (consistently applied) to determine the country’s CPI. § 1.985-1(b)(2)(ii)(D).
- The cumulative inflation rate for the base period is based on compounded interest rates. § 1.985-1(b)(2)(ii)(D).

# Hyperinflationary Currency – Example

- Assume a Country U QBU would use the *u* as its functional currency. The issue is whether the *u* is hyperinflationary in 2013.
- Annual inflation during 36 month testing period:
  - 2010 = 29%
  - 2011 = 25%
  - 2012 = 30%
- The cumulative inflation during the testing period is 110% (1.29 x 1.25 x 1.30 = 2.10; 2.10 – 1 = 1.10), so the *u* is hyperinflationary in 2013. See, e.g., § 1.985-1(b)(2)(ii)(D).
- Suppose instead, that the annual inflation in 2012 is 5%. The cumulative inflation during the testing period would be 69% (1.29 x 1.25 x 1.05 = 1.69), so the *u* would not be hyperinflationary.

# Hyperinflationary Currencies

- Because the methodology used could affect the determination of whether a currency is hyperinflationary, the following lists are merely guides and are not intended to be definitive or exclusive. Also, information is not readily available for certain countries.
- Hyperinflationary currencies:
  - 2009 – Myanmar, Zimbabwe
  - 2010 – Venezuela, Zimbabwe
  - 2011 – Venezuela, Zimbabwe
  - 2012 – Venezuela, Zimbabwe

# Transitioning to DASTM

- If a QBU begins to use DATSM, it must make certain determinations and adjustments required under § 1.985-7.
- Foreign corporation:
  - Recognizing previously unrealized foreign exchange gain or loss on section 988 transactions denominated in USD
  - Reversing certain § 988 transactions occurring during the 36 month look-back period
  - Translating the opening DASTM balance sheet
  - Translating E&P
- U.S. shareholder of a CFC:
  - Recognizing subpart F inclusions on § 988 transactions of the CFC described above (and taking into account foreign taxes under § 960)
  - Recognizing foreign exchange gain or loss on previously taxed income as if it were distributed
- QBU branch:
  - Recognizing previously unrealized foreign exchange gain or loss on § 988 transactions denominated in USD
  - Reversing certain § 988 transactions occurring during 36 month look-back period
  - Taking into account § 987 consequences

# Ceasing to Use DASTM

- A QBU that was required to use the USD as its functional currency is required to change its functional currency from the USD to its "regular" functional currency as of the first day of the first taxable year that follows three consecutive taxable years in which the currency of its economic environment is not a hyperinflationary currency. § 1.985-1(b)(2)(ii)(E).
- For example, suppose a QBU uses the USD as its functional currency because the currency that otherwise would be its functional currency, the *u*, is hyperinflationary. The *u* ceases to be hyperinflationary in 2010 and thereafter. The QBU would be required to change its functional currency from the USD to the *u* as of the first day of 2013.
- The new functional currency of the QBU is determined under the generally applicable rules for determining a QBU's functional currency.
- The change is considered to be made with the consent of the IRS. § 1.985-1(b)(2)(ii)(E).
- Adjustments must be made under the rules generally applicable to changes in functional currency. § 1.985-1(b)(2)(ii)(E).

# Mechanics of DASTM

- Steps
  - Step 1 – The QBU prepares its income or loss statement from its books and records in its hyperinflationary currency. § 1.985-3(b)(1).
  - Step 2 – Adjustments are made to conform the income or loss statement to U.S. GAAP principles and tax accounting principles. § 1.985-3(b)(2).
  - Step 3 – The amounts shown on the adjusted income or loss statement are translated from the hyperinflationary currency to USD. § 1.985-3(b)(3).
  - Step 4 – The resulting USD income or loss or E&P is adjusted to reflect any DASTM gain or loss. § 1.985-3(b)(3).
- USD Transactions – Transactions in USD are reflected on the statement in USD, and no DASTM gain or loss is realized. § 1.985-3(c)(8)(i).
- Third Currency Transactions – Any reasonable method can be used to account for third currency transactions, provided it is consistent with the QBU's method of financial accounting. § 1.985-3(c)(9).

# Translation from Hyperinflationary Currency to USD

- Amounts generally are translated into USD at the exchange rate for the translation period to which they relate. § 1.985-3(c)(1).
- A translation period generally is each month within a QBU's taxable year. § 1.985-3(c)(7)(i). A taxpayer, however, may use periods of equal length that are less than one month, so long as there is not more than one short period annually. § 1.985-3(c)(7)(i). Once an alternative translation period is established, it can be changed only with the consent of the district director. § 1.985-3(c)(7)(i).
- The exchange rate for a translation period may be determined under any reasonable method, provided it is consistently applied and conforms to the taxpayer's method of financial accounting. § 1.985-3(c)(6). Examples of reasonable methods include the average of the beginning and ending exchange rates for the translation period and the spot rate on the last day of the translation period. § 1.985-3(c)(6). Once a method is adopted, it can be changed only with the consent of the district director. § 1.985-3(c)(6).

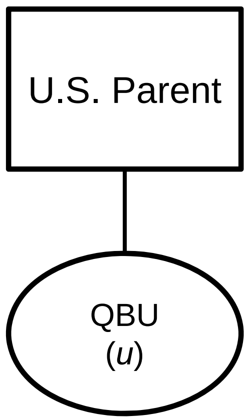
# Translation from Hyperinflationary Currency to USD

- Depreciation, depletion, and amortization are translated at the exchange rate for the translation period in which the cost of the underlying asset was incurred. § 1.985-3(c)(4).
- Prepaid expenses and prepaid income are translated at the exchange rate for the translation period during which the payment was made or received. § 1.985-3(c)(5).
- The USD value of COGS equals the USD value of beginning inventory and purchases, less the USD value of closing inventory. § 1.985-3(c)(2). Reasonable approximations or averages can be used to determine the relevant translation periods for these items. § 1.985-3(c)(3)(B).
  - Closing inventory generally is translated at the exchange rate for the translation period in which the cost of the items was incurred. § 1.985-3(c)(3)(A)(iii).
  - Beginning Inventory is translated to reach the same USD amount as was determined for closing inventory for the preceding taxable year. § 1.985-3(c)(3)(A)(i).
  - Purchases are translated at the exchange rate for the translation period in which the cost of such items was incurred. § 1.985-3(c)(3)(A)(ii).

# DASTM Gain or Loss – § 1.985-3(d)

- DASTM gain or loss equals:
  - The net worth of the QBU at the end of the taxable year minus the net worth of the QBU at the end of the preceding taxable year, plus
  - The USD amount of items that reduce the net worth of the QBU but do not affect its income or loss or E&P (e.g., dividend distributions or branch remittances), minus
  - The USD amount of items that increase the net worth of the QBU but do not affect its income or loss or E&P (e.g., contributions to capital), minus
  - The USD amount of the QBU's profit or positive E&P, if any, as determined in USD, plus
  - The USD amount of the QBU's loss or current year deficit in E&P, if any, as determined in USD.
- For translation rules applicable to remittances or distributions and contributions, see Notice 2005-27. Transferred "historical" items generally are translated using the historical exchange rate, whereas transferred current items are translated using the exchange rate on the date of transfer.
- DASTM gain or loss is treated as ordinary income or loss. § 1.985-3(d)(8).

# DASTM Gain or Loss – Example




- U.S. Parent is a domestic corporation that uses the USD as its functional currency and that owns a Country U QBU.  The QBU would use the *u* as its functional currency except the *u* is hyperinflationary.
- The QBU recognizes $175 of DASTM gain during 2013.
- The DASTM gain is taken into account as taxable income.

| | |
|---|---|
| USD net worth on 12/31/13: | $500 |
| USD net worth on 12/31/12: | - $250 |
| Remittances during 2013: | +$175 |
| Contributions during 2013: | - $200 |
| 2013 income: | - $50 |
| DASTM gain | $175 |

# DASTM Gain or Loss – Translation Rules

- For purposes of determining the net worth of a QBU, balance sheet assets and liabilities are translated from the hyperinflationary currency into USD.
- Balance sheet items roughly divide into two groups: “historical” items and “current” items. Current items generally include items for which the USD value changes with fluctuations in the exchange rate. For example, the USD value of a financial asset denominated in hyperinflationary currency changes as a result of exchange rate fluctuations.
- Historical items generally are translated using the exchange rate for the period in which the cost of the item was incurred. Because this rate does not change, these items generally will not give rise to DASTM gain or loss.
- Current items generally are translated using the exchange rate for the last translation period in the taxable year, which changes from year to year. Thus, these items generally will give rise to DASTM gain or loss.

# DASTM Gain or Loss – Translation Rules

- Historical assets and liabilities
  - Closing inventory – exchange rate for translation period in which the cost of the items was incurred. § 1.985-3(d)(5)(i).
  - Prepaid income or expense – exchange rate for the translation period during which the payment was made or received. § 1.985-3(d)(5)(iii).
  - Certain tangible and intangible property (e.g., PPE and goodwill) – exchange rate for translation period in which the cost of the item was incurred. § 1.985-3(d)(5)(v)(A). Cost recovery deductions are taken into account using the exchange rate for the translation period in which the cost of the underlying asset was incurred. § 1.985-3(d)(5)(v)(B).
  - Other assets and liabilities – exchange rate for translation period in which the cost of the asset or the amount of the liability was incurred. § 1.985-3(d)(5)(ix).

# DASTM Gain or Loss – Translation Rules

- Current assets and liabilities
  - Bad debt reserves – exchange rate for the last translation period in the taxable year. § 1.985-3(d)(5)(ii).
  - Hyperinflationary currency and deposits – exchange rate for the last translation period in the taxable year. § 1.985-3(d)(5)(iv).
  - Hyperinflationary debt obligations – exchange rate for the last translation period in the taxable year. § 1.985-3(d)(5)(vi).
  - Certain hyperinflationary financial instruments (e.g., forward contracts) – exchange rate for the last translation period in the taxable year. § 1.985-3(d)(5)(viii).
- Assets denominated in hyperinflationary currency generally decrease a QBU's net worth. This tends to increase DASTM gain or decrease DASTM loss.
- Conversely, liabilities denominated in hyperinflationary currency generally increase the QBU's net worth. This tends to increase DASTM loss or decrease DASTM gain.

# DASTM Gain or Loss – Effects and Allocation

- DASTM gain or loss is taken into account in determining income or loss or E&P of the QBU. § 1.985-3(e)(1).
- The allocation of DASTM gain or loss is relevant for various purposes, including for foreign tax credit and subpart F purposes.
- DASTM gain or loss must be allocated under either a short-form or long-form method. § 1.985-3(e)(1).
    - A "small QBU" may elect the short-form method. § 1.985-3(e)(2)(i).
    - A QBU generally is an eligible small QBU if the adjusted basis of assets is no greater than $10 million.
    - If such an election is made, there are conformity requirements for other related small QBUs. § 1.985-3(e)(2)(v).
- Under the short-form method, DASTM gain or loss is allocated ratably to all items of a QBU's gross income. § 1.985-3(e)(2)(iv).
- Other QBUs must use the long-form method.

# DASTM Gain or Loss – Long-Form Allocation Method

- Step 1 – prepare beginning and closing balance sheets for the QBU for each balance sheet period
  - The balance sheet periods can differ from the translation periods.
  - The balance sheet items are translated using the rules for determining the QBU's net worth.
- Step 2 – identify "current" assets and liabilities described in § 988
  - These include items such as hyperinflationary currency (including deposits), liabilities denominated in hyperinflationary currency, and financial instruments
- Step 3 – characterize assets identified in Step 2 by the source and type of income they generate (applying the principles of § 1.861-9T(g)(3))
  - This step incorporates the rules for grouping assets from the interest expense allocation and apportionment rules.

# DASTM Gain or Loss – Long-Form Allocation Method

- Step 4 – attribute DASTM gain or loss to the assets in each group using a formula taking into account the beginning and ending basis and the beginning and ending exchange rates
  - The formula effectively multiplies the average basis of the assets in terms of hyperinflationary currency by the average exchange rate.
  - Example – Assume the beginning basis of the QBU's assets that generate general limitation income is *u*75 and the ending basis is *u*125. The beginning exchange rate is 2:1 and the ending exchange rate is 5:1. The DASTM loss attributable to the general limitation assets is ($30) = ((*u*75 + *u*125) / 2) x ((1/5) – (1/2))
- Step 5 – adjust the USD gross income generated by each group's assets by the amount of DASTM gain or loss attributable to the group
- Step 6 – attribute DASTM gain or loss to the liabilities in each using a similar formula
- Steps 7 and 8 – adjust the USD income or expense generated by each group's liabilities by the amount of DASTM gain or loss attributable to the group
- Step 9 – allocate the residual DASTM gain or loss based on gross income

# Circular 230 Statement

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