



United States Tax Alert

Final PFIC regulations clarify indirect ownership issue, address Form 8621 annual reporting requirements

On December 27, 2016, the Department of the Treasury and the IRS issued final regulations providing guidance on determining ownership of a passive foreign investment company (PFIC) and the application of the requirement that PFIC and qualified electing fund (QEF) shareholders file a Form 8621 annual information return.¹ The regulations finalize, with modifications, temporary and proposed regulations issued in 2013² (“2013 temporary regulations”) and adopt exceptions from Form 8621 reporting announced in Notice 2014-28³ (exception for ownership through tax-exempt organization or account) and Notice 2014-51⁴ (exception for PFIC stock already subject to mark-to-market reporting), as well as additional new exceptions. The final regulations are generally effective for tax years of shareholders ending on or after December 31, 2013, the publication date of the 2013 temporary regulations.

The guidelines for determining indirect ownership of PFIC stock in the final regulations generally reflect the framework initially set forth in proposed regulations promulgated in 1992 (“1992 proposed regulations”).⁵ Under this framework, a US person who directly or indirectly owns 50% or more of the value of a foreign corporation that is not a PFIC is considered to own a proportionate amount of stock owned (directly or indirectly) by that foreign corporation. For the purpose of determining whether the 50% ownership threshold is satisfied, if stock of the non-PFIC is held indirectly through a domestic C-corporation, the indirect ownership rules apply to look through the domestic C-corporation to the stock of the non-PFIC.⁶ The final regulations clarify that the attribution to a shareholder of non-PFIC stock held by a domestic C-corporation is solely for the purpose of attributing PFIC stock that is not already considered to be directly or indirectly owned by another US person; consistent with

this clarification, a new non-duplication rule prevents ownership from being attributed to multiple US persons.

The final regulations illustrate the application of these rules with the following example:

A is a United States person who owns 49 percent of the stock of FC1, a foreign corporation that is not a PFIC, and separately all the stock of DC, a domestic corporation that is not an S corporation. DC, in turn, owns the remaining 51 percent of the stock of FC1, and FC1 owns 100 shares of stock in a PFIC (which is not a controlled foreign corporation within the meaning of section 957(a)).

To determine whether A owns 50% or more of FC1 for the purpose of attributing stock owned directly or indirectly by FC1 to A, A is treated as owning the stock of FC1 that it owns directly (i.e., 49%), as well as the FC1 stock held by DC (i.e., the remaining 51%). Because A is treated as owning 50% or more of the stock of FC1, a non-PFIC foreign corporation, A is treated as owning a proportionate amount of stock owned (directly or indirectly) by that foreign corporation. Under the non-duplication rule, however, to the extent that the 51 shares of PFIC stock are considered indirectly owned by DC, a US person, those shares are not also treated as indirectly owned by A. Rather, only the remaining 49 shares of PFIC stock are considered to be indirectly owned by A.

The centerpiece of the final regulations is a wide array of exceptions to annual information reporting on Form 8621, a statutory requirement that was implemented in the 2013 temporary regulations.⁷ In addition to the \$25,000 and \$5,000 threshold exceptions included in the 2013 temporary regulations, the regulations now include exceptions from annual reporting for:

- Stock that is marked to market under a regime other than section 1296. This exception, which originated in Notice 2014-51, does not apply to the first taxable year in which the US owner marks the stock to market if the stock was acquired in a previous year.⁸
- Shareholders that are tax-exempt organizations or hold their PFIC interests through a tax-exempt investment vehicle, as announced in Notice 2014-28.
- Domestic partnerships in which none of the partners are subject to the PFIC reporting rules. However, a domestic partnership that holds stock in a section 1291 fund is required to file Form 8621 if it has partners that are exempt from filing an annual information report but would be subject to tax with respect to distributions from, or dispositions of, the PFIC.
- Stock of a section 1291 fund held for 30 days or less during the 59-day period starting 29 days before the first day of a US person's taxable year, if the shareholder did not receive any excess distributions.
- Stock held through foreign pension funds with respect to which the US persons are eligible for deferral under US income tax treaties, regardless of the structure of the foreign pension funds.
- Dual resident taxpayers treated as residents of another country (i.e., as nonresident aliens for US federal income tax

reporting purposes) pursuant to a tie-breaker rule in the income tax treaty between the United States and the other country, provided that such taxpayers file Form 8833 (Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)) with an appropriate income tax return.

The final regulations do not permit a US person to file a consolidated Form 8621 containing all of the person's PFICs and relevant information on a supporting schedule, rather than filing individual Forms 8621 for each PFIC. Further, the final regulations do not permit the filing of a protective Form 8621 when a shareholder is unsure of a particular foreign corporation's PFIC status because it lacks access to the books and records of the corporation necessary to make the PFIC determination; however, if the shareholder has reasonable cause for not filing the form, then under an existing reasonable cause exception the assessment statute will only be suspended for the PFIC items on the return, rather than for the entire tax return.

The final regulations clarify how to file Form 8621 when a US tax return is not filed. In such case, the Form 8621 must be filed in accordance with the instructions for the form.

The final regulations also finalize guidance on an exception to the requirement to file Form 5471 for certain constructively-owned stock.

¹ T.D. 9806, 81 Fed. Reg. 95,459 (Dec. 28, 2016).

² T.D. 9650, 78 Fed. Reg. 79,602 (Dec. 31, 2013).

³ 2014-18 I.R.B. 990 (Apr. 28, 2014).

⁴ 2014-40 I.R.B. 594 (Sept. 29, 2014).

⁵ 57 Fed. Reg. 11,024 (Apr. 1, 1992).

⁶ This domestic C-corporation attribution rule previously applied only to stock in section 1291 funds. However, to enable indirect shareholders of PFICs to make QEF elections, the final regulations extend this attribution to all PFIC stock. Further, with respect to stock indirectly held through an S-corporation, each shareholder is considered to own the stock proportionately, based on the shareholder's percentage ownership of the S-corporation.

⁷ See I.R.C. §1298(f).

⁸ The US owner is subject to section 1291 for the year in which the non-section 1296 mark-to-market election takes effect.

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