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GMS Flash Alert

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United States - IRS Issues Final PFIC Regulations

On December 28, 2016, the U.S. Department of the Treasury and the Internal Revenue Service (IRS) issued final regulations that provide guidance on the annual reporting requirements for U.S. persons that own interests in passive foreign investment companies (PFICs).[1]

The final regulations retain the basic approach as the temporary regulations issued in 2013,[2] with certain revisions and clarifications. These include:

- requiring that a U.S. person owning multiple PFICs to file a separate Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund* for each PFIC; and

- clarifying that individuals who are treated as U.S. nonresidents under the tie-breaker provisions of an income tax treaty are exempt from filing Form 8621 for the portion of the tax year that the individual is taxed as a nonresident.

Additional revisions and clarifications contained in the final regulations are discussed below.

WHY THIS MATTERS

Form 8621, the annual PFIC information report, is considered part of the U.S. income tax return. A U.S. income tax return is not complete unless the Form 8621, if required, is attached. The final regulations provide clarification on how to comply with annual PFIC information reporting and, in some cases, provides welcome relief from the annual reporting requirement.

Background

The HIRE Act of 2010 added section 1298(f) to the U.S. Internal Revenue Code (the "Code"). This provision requires all U.S. persons who are shareholders of a PFIC to report their ownership of the PFIC on Form 8621 even when there is no other requirement to file Form 8621, such as receipt of an excess distribution or making the qualified electing fund or mark-to-market elections. Section 1298(f) was effective as of March 18, 2010.

On December 31, 2013,[3] the IRS and the Treasury issued temporary regulations which provided guidance for the annual filing requirement for shareholders of PFICs including the time and manner for filing Form 8621for tax years ending on or after December 31, 2013.

Final Regulations

Definition of Shareholder and Indirect Shareholder

The final regulations provide that a U.S. person that owns stock of a PFIC through certain U.S.-based tax exempt organizations or accounts (including U.S. non-profit entities and U.S. qualified pension, profit-sharing and stock bonus plans) is not treated as a shareholder of the PFIC. These shareholders are not subject to the PFIC tax rules or the PFIC information reporting requirements.

Manner of Filing Form 8621

The final regulations clarify that a U.S. person that owns a PFIC but is not otherwise required to file a U.S. tax return must still file Form 8621 in accordance with the form instructions.

The final regulations require that a U.S. person owning multiple PFICs must file a separate Form 8621 for each PFIC.

KPMG NOTE

KPMG LLP (U.S.) submitted a comment to the IRS recommending that the final regulations allow a U.S. person owning multiple PFICs to file a consolidated Form 8621, which would include all relevant information on a supporting schedule attached to the form. This approach would alleviate the administrative burden and financial cost of preparing and filing multiple Forms 8621. This recommendation was not adopted in the final regulations.

Exceptions to Annual PFIC Information Reporting

Dual-resident taxpayers who are treated as residents of another country pursuant to an income tax treaty – The final regulations provide an exemption from the annual PFIC information reporting requirement for certain dual-resident taxpayers who are treated as U.S. nonresidents under the provisions of an income tax treaty (commonly known as "treaty tie-breaker aliens") and who properly file Form 8833, *Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)* for the portion of the tax year that the individual is taxed as a nonresident.

KPMG NOTE

Prior to the issuance of the final regulations, it was unclear whether dual-resident taxpayers were subject to the annual PFIC information reporting requirement. Although such individuals were not subject to tax under the PFIC rules (which only apply to U.S. persons), absent a specific exception, a dual-resident taxpayer may be treated as a U.S. resident under the Code for purposes other than the computation of his income tax liability, such as information reporting requirements. The rule contained in these final PFIC regulations is consistent with the reporting exception provided to dual-resident taxpayers under the FATCA (Form 8938, *Statement of Specified Foreign Financial Assets*) and reflects the recommendation submitted to the IRS by KPMG LLP (U.S.).

Treaty-based reporting exception for PFIC stock held through a foreign pension fund is expanded to PFICs held through all foreign pension funds regardless of entity classification – Under the temporary regulations, a U.S. person was exempt from the annual PFIC information reporting requirement for PFIC stock owned through a foreign pension fund classified as a trust when, under the provisions of a U.S. income tax treaty, the income earned by the pension fund may be taxed to the U.S. beneficiary only upon distribution. Thus, this reporting exception only applied when a U.S. person owns a PFIC through a foreign pension fund that is treated as a foreign trust for U.S. income tax purposes.

The applicable provisions of U.S. income tax treaties apply to foreign pension funds without regard to whether the funds are treated as trusts for U.S. income tax purposes. Therefore, the final regulations expand the treaty-based reporting exception to PFICs held by U.S. persons through all applicable pension funds, regardless of their entity classification for U.S. income tax purposes. Thus, a foreign pension fund covered by this reporting exception may be any type of arrangement.

Reporting exception for certain bona fide residents of U.S. territories – The final regulations introduce a reporting exception for bona fide residents of Guam, the Northern Mariana Islands, or the U.S. Virgin Islands who are not required to file a U.S. tax return with the IRS for the tax year. This reporting exception does not apply to bona fide residents of Puerto Rico and American Samoa.

Reporting Exception for PFIC stock held for 30 days or less – The final regulations introduce a reporting exception for transitory ownership of PFIC stock. Under this rule, no reporting requirement applies in relation to PFIC stock that is acquired during the tax year or the immediately preceding tax year, provided the PFIC is held for 30 days or less during the period that begins 29 days before the first day of the shareholder's tax year and ends 29 days after the close of the shareholder's tax year. This exception also requires that no excess distribution or gain treated as excess distribution is received with respect to the PFIC in question.

Additional Changes

Additional revisions to the 2013 temporary regulations include:

- Guidance as to when a U.S. person is treated as an indirect shareholder of a PFIC as a result of attribution through a U.S. corporation (inclusion of a non-duplication rule).

- Inclusion of a reporting exception for PFIC stock marked to market under a Code section other than section 1296 (originally announced in Notice 2014-51).

- Adoption of a rule that exempts a U.S. partnership from annual PFIC information reporting with respect to an interest in a PFIC for a tax year when none of its direct or indirect partners are required to file Form 8621 because the partners are not subject to the PFIC rules.

FOOTNOTES:

1 TD 9806. For the text of the final regulations, click here.

2 For prior coverage of the December 2013 temporary regulations, see KPMG's *Flash International Executive* Alert 2014-002 (January 10, 2014).

3 T.D. 9650, 78 Fed. Reg. 79602 (December 31, 2013).

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Watch the latest GMS video "The Importance of Certificates of Coverage When Sending Employees Overseas"!

Why should employees being sent on assignment overseas obtain Certificates of Coverage prior to starting work in the host country? What purpose do they serve? How long are they valid for? Are they required for all kinds of assignments (e.g., commuter assignments, short-term, long-term, frequent business traveler)?
In this video, featuring Bob Rothery and Stacy Finch with the KPMG LLP (U.S.) Global Mobility Services practice, we delve further into the nuts and bolts of social security totalization agreements and learn about certificates of coverage, the "detached worker rule," the application of home versus host country social security rules, in general, to different kinds of assignments, and respective employee and employer obligations and responsibilities.

We invite you to watch this new video, "The Importance of Certificates of Coverage When Sending Employees Overseas," from KPMG's GMS practice (app. 8-1/2 minutes).

The above information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 as the content of this document is issued for general informational purposes only.

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