Controlled Foreign Corporations (CFCs) & Passive Foreign Investment Companies (PFICs)

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STEP USA
ADVISING FAMILIES ACROSS GENERATIONS

Overview

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  - Fundamentals
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  - Fundamentals
  - Case studies
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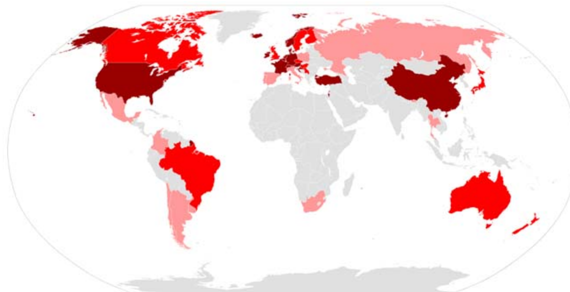
U.S. International Investment in Stock



As of the end of 2014, the U.S. Treasury reported U.S. portfolio holdings of foreign securities at approximately $9.64 trillion

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U.S. International Investment in Stock

Market value of U.S. holdings of foreign securities, by country and type of security, for the countries attracting the most U.S. investment, as of December 31, 2014 per https://www.treasury.gov/press-center/press-releases/pages/jl0333.aspx

Country or category	Total	Equity	Debt		
			Total	Long-term	Short-term
United Kingdom	1,300	922	378	312	66
Cayman Islands	1,150	858	292	289	2
Canada	844	417	427	379	48
Japan	689	592	97	83	14
France	485	318	167	129	38
Switzerland	424	409	15	10	4
Netherlands	388	233	155	142	13
Ireland	387	332	55	53	2
Germany	375	274	101	85	16
Australia	311	140	171	128	44
Bermuda	227	198	30	30	*
Korea, South	178	141	37	36	1
Brazil	166	109	56	56	*
Mexico	166	67	99	92	7
Sweden	165	85	80	40	39
Rest of world	2,385	1,667	718	645	75
Total	**9,640**	**6,762**	**2,878**	**2,509**	**369**

* Greater than zero but less than $500 million.

[1] The stock of foreign securities for December 31, 2014, reported in this survey may not, for a number of reasons, correspond to the stock of foreign securities on December 31, 2013, plus cumulative flows reported in Treasury's transactions reporting system. An analysis of the relationship between the stock and flow data is available in Table 4 and the associated text of the "Report on U.S. Portfolio Holdings of Foreign Securities" at end-year 2014.

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U.S. Anti-deferral Regime

- Purpose of the CFC and PFIC Anti-deferral Regimes
  - Concerned that U.S. taxpayers were not paying taxes by investing in foreign corporations, Congress enacted subpart F of the Internal Revenue Code in 1962, followed by the PFIC rules in 1986. The purpose of both sets of rules is to discourage U.S. taxpayers from using foreign corporations in low tax jurisdictions to defer payment of U.S. income tax by targeting easily movable income:
    - Passive income; and
    - Income derived from transactions with related corporations.

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Controlled Foreign Corporation (CFC)

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Controlled Foreign Corporation (CFC)

- Entity must be a corporation
  - Entity classification regulations– Treas. Reg. §301.7701-2 & 3
- Under §957(a) a foreign corporation is a CFC if:
  - "U.S. Shareholders" own more than 50% of the total value or voting power
  - "U.S. Shareholder" means a U.S. person who owns at least 10% of the total *voting power*

- Community property marital regimes create potential CFC issues
  - U.S. spouse owns interest in non-U.S. spouse's holdings

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CFC Ownership by Attribution

- Direct and Indirect Ownership (§958(a))
  - Stock owned directly or indirectly by or for a foreign corporation, foreign partnership, foreign trust, or foreign estate is treated as owned proportionately by its shareholders, partners, or beneficiaries
  - Ownership attribution stops at the first U.S. person
    - *See Textron v. Comr.* where U.S. grantor trust owned CFC stock
- Constructive Ownership (§958(b))
  - Applies the constructive ownership rules of §318
    - §318 attributes:
      - Grandparent as owning stock of grandchildren
      - Spouse as owning stock of other spouse
      - Parent as owning stock of children
      - Child as owning stock of parent
  - Constructive Ownership Rules are not applied to make U.S. person the owner of stock owned by a nonresident alien (§958(b)(1))
    - This does not apply to a foreign trust or estate, *See* Treas. Reg. §1.958-2(b)(3).
  - Stock owned by non-grantor trust is treated as owned by beneficiaries in proportion to their interest, *See* Treas. Reg. §1.958-2(c)(1)(ii)(a)
  - Stock owned by grantor trust is treated as owned by grantor(s), *See* Treas. Reg. §1.958-2(c)(1)(ii)(b)
  - Greater than 50% voting stock ownership in a corporation---> deemed to own all voting stock of the corporation (applies to partnerships, estates, trusts and corporations)

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Taxation of CFC's U.S. Shareholders

- Ownership's Effect: Taxable Income to U.S. Shareholder
  - Pro rata share of:
    - Subpart F income; and
    - Earnings invested in U.S. property
- Subpart F Income includes but not limited to
  - Foreign Personal Holding Company Income
    - §§954(a)(1) and (c)
  - Foreign Base Company Sales Income
    - §§954(a)(2) and (d)
  - Foreign Base Company Services Income
    - §§954(a)(3) and (e)
- Election to be Taxed at Corporate Rates (§962)
  - Allows a foreign tax credit

CFC Subpart F Income Exceptions

- Exceptions to Subpart F Income
  - Active Trade or Business Exception
  - Same Country Exception
    - Assumes foreign corporation has a legitimate purpose if organized in same country in which actively conducting business (e.g., leasing property in same country or selling goods intended for use or sale in same country)
  - CFC Look-through Rule (§954(c)(6))
    - Extended by: Consolidated Appropriations Act, 2016 (P.L. 114-113)
    - Applies to: dividends, interest, rents, and royalties received from a related CFC that when earned would not be Subpart F income or income effectively connected to a U.S. trade or business
      - Related = greater than 50% ownership by vote or value

Putting the CFC Pieces Together

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Planning with CFCs and Foreign Corporations

- Consider a "check the box" election
  - This may cause a step-up in basis of the company's assets
  - Caution:
    - Per se corporations
    - Relevance
- Consider using non-voting stock
- Watch currency gains and losses on distribution of previously taxed income-- §986(c)
- Pending tax reform proposals
- State income tax characterization and taxation

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Inbound Inheritance of CFC Stock from NRA

Situation: Current foreign company stock is owned 100% by an NRA either individually or in a foreign grantor trust, and at NRA's death such stock will be either directly or indirectly owned by a U.S. person under the CFC ownership/attribution rules.

Question: Is there proactive planning that the NRA can take now, or at NRA's death through his agents, to avoid CFC issues and reporting for his U.S. person heirs?

Answer: Yes, using the "check-the-box" (CTB) rules. CTB elections can be made retroactive for up to 75 days before the election and provide planners much flexibility at an NRA's death with respect to entity interests. But, there are steps that should be adhered to when making this election.

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Inbound Inheritance of CFC Stock from NRA

Step 1: Is CFC a foreign "eligible entity"?

- Make sure CFC is not a per-se corporation (if so, no CTB planning available)
- Make sure the entity is a foreign eligible entity whose default classification is a foreign corporation (limited liability to all owners)

Step 2: Is the CFC a "relevant" foreign eligible entity?

- Relevance matters, as without relevance CTB election is an *initial* classification election
  - Not important if only assets are foreign situs in CFC
- Relevance = When a foreign eligible entity's classification affects the liability of any person for federal tax or information purposes
  - Ex. A foreign entity's classification would be relevant if U.S. income was paid to the entity and amount withheld (if any) would vary depending upon whether the entity is classified as a partnership or as an association.
- Strong preference for owning ECI producing assets (withholding rates and tax rates differ if the foreign entity is a foreign corporation)
- Without obligation to file a Form 1120-F (which most foreign corporations owning passive U.S. investments and partnership interests do not due to certain withholding tax provisions), then can argue relevance by investing in U.S. source income producing assets and providing a Form W-8BEN-E
  - Better than nothing.

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Inbound Inheritance of CFC Stock from NRA

Step 3: Assuming foreign eligible entity is relevant and is treated as a foreign corporation, then what are the CFC's underlying assets – foreign situs or U.S. situs?

- Situs is a transfer tax concept (i.e., U.S. gift and estate taxes)
- Determine whether U.S. transfer tax would be owed by the NRA decedent if the underlying assets of the CFC were included in his U.S. taxable estate.
- All Foreign Situs Assets:
  - Consider CTB election effective as of the day *before* the NRA decedent's death
  - Makes the foreign corporation a *disregarded entity* and the assets of the foreign company would be deemed owned by the NRA personally
  - Such assets, if foreign situs, would not be subject to U.S. estate tax and would get a step-up in basis since the assets would be included in the NRA decedent's gross estate
    - *Note:* Be wary of underlying PFICs as these may be problematic in the future for U.S. person owners.
      - » However, unlike when PFIC stock is inherited from U.S. persons, PFIC stock inherited from NRA decedent gets a basis step up.
    - *Note:* Relevance technically does not matter in this situation, as even an initial classification as a disregarded entity would accomplish the same goals.

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Inbound Inheritance of CFC Stock from NRA

- All U.S. Situs Assets: By doing a CTB election effective as of the day *after* the NRA decedent's death, makes the relevant foreign corporation a *disregarded entity* as of the day after the NRA decedent's death:
  - Day of Death = Relevant foreign corporation, so acts as a "blocker" for U.S. estate tax purposes on the underlying U.S. situs assets
  - CTB Election treated as deemed liquidation and should not result in material U.S. income taxes if the company only owns intangible investment assets and not U.S. real property
  - Is a CFC for one day
    - But, the Subpart F rules only apply if there is a U.S. Shareholder for 30 days
    - So, gain on the deemed sale of the foreign corporation's assets will not result in Subpart F income to the new shareholders under Section 951
  - If stock is held by foreign estate, then no tax on deemed liquidation under Section 331.
  - But, if under local law shares automatically pass to U.S. heirs, then there may be a taxable transaction to the U.S. shareholders under Section 331
    - This is because the gain realized by the foreign company pursuant to the liquidation would not be taxed to the U.S. heirs as Subpart F income, so the gain or loss realized by the U.S. heirs under Section 331 would be based on the change in value (if any) of the foreign company stock between the date of death and the date of liquidation (one day)
  - Purpose of this Strategy = Get U.S. heirs an indirect step-up in basis in assets of the foreign company without paying U.S. estate tax

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Passive Foreign Investment Company (PFIC)

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International Taxation
U.S. Taxation of Foreign Persons and Foreign Income – 4th edition

Proposed regulations on PFICs, concerned mainly with the regime of code section 1291 (the "pure" PFIC regime), were issued in April 1992. Additional regulations, both proposed and final, were issued in 1993, 1995, 1996, 1997, 1998, 2000, 2004, 2005 and 2007. The regulations introduced a colorful vocabulary to describe the different flavors of PFIC and the effect of different elections. The mélange of acronyms and pet fancy includes "PFIC, QEF, pedigreed QEF, un-pedigreed QEF, nonqualified fund, and code section 1291 fund." The denizens of this menagerie are explained later in this chapter. Meanwhile, the preamble accompanying the 1992 proposed regulations is unusually lucid. Even though it means extolling a competing source of information that is available free of charge, I must advise the reader that the drafter’s explanation is an exemplary overview of the entire PFIC system.

Joseph Isenbergh, Professor of Law, University of Chicago

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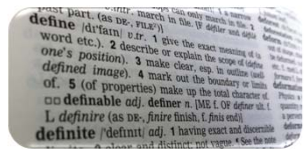
Passive Foreign Investment Company (PFIC)

- A foreign entity is a PFIC under §1297(a) if it is a foreign *corporation* and:
  - 75% or more of its gross income is passive,
  - Average percentage of assets producing or held for production of passive income is 50% or more, OR
  - The foreign corporation previously qualified as a PFIC and such status was not 'purged' ("Once a PFIC always a PFIC" rule)
- CFC Overlap Rule (§1297(d))
  - Effective 1/1/1998 CFC rules trump PFIC rules for "US Shareholder"
  - Not a panacea
- Holding Company Exception (§1297(c))
  - 25% or greater ownership of stock of another corporation applies a look-through rule to deem activities and assets held by the subsidiary to be performed or held proportionally by the parent

- Community property regimes also create PFIC issues
  - a U.S. spouse owns an interest in non-U.S. spouse's holdings and distributions



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PFIC Stock Attribution Rules

- Attribution
  - Corporation
    - If 50% or more (by value only) of stock is owned directly or indirectly by or for any person, such person shall be considered as owning a proportionate amount of PFIC stock owned by the corporation (§1298(a)(2)(A))
    - If person owns stock in a PFIC that owns stock in another PFIC, the 50% limitation does not apply (§1298(a)(2)(B))
  - Partnerships, Trusts, and Estates
    - Partners and beneficiaries treated as owning their proportionate amount of stock owned by a partnership, trust, or estate (§1298(a)(3))
    - Stock owned by foreign non-grantor trust is treated as owned by the beneficiaries in proportion to their interest as supported by all the facts and circumstances, *See* Temp. Treas. Reg. §1.1291-1T(b)(8)
    - Stock owned by foreign grantor trust is treated as owned by grantor(s) proportionally, *See* 1986 Blue Book at 1032 and Temp. Treas. Reg. §1.1291-1T(b)(8)
  - Stock owned by a foreign person once attributed to a U.S. person is not further attributed (§1298(a)(1))
- Loss of attribution
  - "Under regulations" treated as a sale of PFIC stock (§1298(b)(5))

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Taxation of PFICs

- Three tax regimes
  - §1291 Fund throwback taxation
    - General rule
  - §1293 Qualified Electing Fund flow through taxation
    - Requires §1295 election
  - §1296 Mark to market taxation
    - Requires §1296 election

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Taxation of §1291 Funds – General Rule

- Throwback tax applies to gains from the sale of PFIC shares and "excess distributions"
- Excess distribution is the amount of *distributions* for the tax year over 125% of the trailing 3-yr. average of distributions
  - *Amount of distribution not in excess of the 125% floor amount taxable under §301*
- Gains and excess distribution allocated on a per day basis over holding period for the stock
  - Portion attributable to current year and years when the corporation was not a PFIC included in ordinary income
  - Portion attributable to prior years, when corporation was a PFIC, subject to a throwback calculation as provided in §1291(c)

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Qualified Electing Fund

- The §1295 Election
  - May be made by any U.S. person holding PFIC stock
    - Made by first US shareholder in chain of ownership
  - Generally, the PFIC must provide a PFIC Annual Information Statement
    - Report pro rata share of ordinary earnings and net capital gain
    - Statement that shareholder is allowed to inspect book and records
- Pedigreed vs. Unpedigreed QEF
  - Purging elections

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QEF Taxation

- Electing shareholder taxed on pro rata share of ordinary income and net capital gain
  - Increase in basis for amounts included in income
  - Losses do not flow through and deficits in E&P do not carry forward
- Pedigreed QEF – gain on sale of stock treated as a capital gain

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Mark to Market Election

- Mark-to-Market Election (§1296)
  - Made by US person
  - Stock held directly or through a foreign pass-through entity
    - Exception for stock held by CFC - §1296(f)
  - Cannot be made for PFIC shares held by another PFIC
  - Only allowed if the PFIC stock is marketable
    - Regularly traded on a qualified exchange or other market
    - Comparable to a Regulated Investment Company as provided in regulations
  - Potential §1291 taxation for elections made after first PFIC year

Mark to Market Taxation

- Shares must be marked to market annually
- Any increase in value is taxed as ordinary income
  - Increase in stock basis
- Any decrease in value is allowed as ordinary loss to extent of previous income recognition – "unreversed inclusions"
  - Decrease in stock basis
- Gain on sale taxed as ordinary income
- Loss on sale treated as ordinary income to extent of unreversed inclusions.
  - Remainder of any loss treated as a capital loss

PFICs – Items of Interest

- No basis step up for shares in §1291 Fund at death - §1291(e)
  – Exception if shares held at all times up to death by NRA decedent
- §1291 can tax a return of capital distribution
- Generally, PFIC rules apply on a share lot basis
- Transactions in foreign currency require special attention
- Treatment under §1411 net investment income tax
- State income tax characterization and taxation
- Purging the PFIC taint

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Putting the PFIC Pieces Together

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Example 1
§1298(a)(3) Attribution

US resident alien A is a beneficiary of an employer-sponsored foreign pension plan treated as a nongrantor trust for US purposes. The plan has 10,000 participants. The trust holds interests in non-US registered mutual funds that are characterized as PFICs. The plan is not covered by an income tax treaty and A has not made any elections with respect PFICs held by the trust.

A is treated as the owner of his proportional share of each of the PFICs held by the pension plan. §1298(a)(3). Section 1298(b)(5)(A) provides that "under regulations" A must apply the rules of §1291 to determine the US taxation of his proportional share of any PFIC distributions or gains on disposition.

Additionally, A may be subject to information reporting under §1298(f).

Example 2
Indirect Sale of PFIC Stock by CFC

US Taxpayer ("UST") owns 100% of the stock of a foreign corporation treated as a controlled foreign corporation or CFC. The CFC owns an interest in a PFIC sold at a gain of $100,000. No §1293 election was ever made.

Is the gain taxable to UST as subpart F income under §951 or as an excess distribution under §1291, or both?

How is this transaction reflected on Form 5471?

Example 2 (cont'd)

Under the coordination rule provided in Prop. Reg. §1.1291-3(e)(4)(ii), the gain is taxed in full to UST as an excess distribution under §1291. The income is not subject to §951.

Prop. Reg. §1.1291-3(e)(4)(iii) provides for an adjustment to the basis in shares of the CFC owned by UST through which he indirectly owns the §1291 fund.

Prop. Reg. §1.1291-3(e)(4)(iv) applies the principles of §959, previously taxed income, to distributions from the CFC to UST to the extent attributable to the gain taxed to UST.

Form 5471; Schedule J

SCHEDULE J (Form 5471) (Rev. December 2012) Department of the Treasury Internal Revenue Service

Accumulated Earnings and Profits (E&P) of Controlled Foreign Corporation

► Information about Schedule J (Form 5471) and its instructions is at www.irs.gov/form5471.
► Attach to Form 5471.

OMB No. 1545-0704

Name of person filing Form 5471: US TAXPAYER — Identifying number: 123-45-6789

Name of foreign corporation: CFC LTD — EIN (if any): NONE — Reference ID number (see instructions): REFERENCE1

Important: Enter amounts in functional currency.	(a) Post-1986 Undistributed Earnings (post-86 section 959(c)(3) balance)	(b) Pre-1987 E&P Not Previously Taxed (pre-87 section 959(c)(3) balance)	(c) Previously Taxed E&P (see instructions) (sections 959(c)(1) and (2) balances) (i) Earnings Invested in U.S. Property	(ii) Earnings Invested in Excess Passive Assets	(iii) Subpart F Income	(d) Total Section 964(a) E&P (combine columns (a), (b), and (c))
1 Balance at beginning of year	NONE				NONE	NONE
2a Current year E&P	100,000					
b Current year deficit in E&P						
3 Total current and accumulated E&P not previously taxed (line 1 plus line 2a **or** line 1 minus line 2b)	100,000					
4 Amounts included under section 951(a) or reclassified under section 959(c) in current year	100,000				* 100,000	
5a Actual distributions or reclassifications of previously taxed E&P						
b Actual distributions of nonpreviously taxed E&P						
6a Balance of previously taxed E&P at end of year (line 1 plus line 4, minus line 5a)					100,000	
b Balance of E&P not previously taxed at end of year (line 3 minus line 4, minus line 5b)	NONE					
7 Balance at end of year. (Enter amount from line 6a or line 6b, whichever is applicable.)	NONE				100,000	100,000

For Paperwork Reduction Act Notice, see the Instructions for Form 5471. Cat. No. 21111K Schedule J (Form 5471) (Rev. 12-2012)

* THIS AMOUNT REPRESENTS GAIN FROM INDIRECT DISPOSITION OF PASSIVE FOREIGN INVESTMENT COMPANY (PFIC) TAXED UNDER IRC SECTION 1291 (SEE FORM 8621 INCLUDED) PURSUANT TO PROP. TREAS. REG. SEC. 1.1291-3(e)(4)(ii).

Example 3
Gain from sale of Gifted PFIC

Individual A is a US citizen. On August 1, 2004 Individual A received a gift from his nonresident alien aunt in Switzerland of shares in a PFIC. At the time of the gift the shares were worth $160,000. The aunt acquired the shares on May 15, 1991 for US$10,000. Individual A sold the shares on December 1, 2015 for US$200,000.

How is the gain on disposition tax under §1291?

Example 3
Gain from sale of Gifted PFIC

Individual A			
PFIC §1291 Calculations			
Tax Year 2015			
Fund Name			PFIC
Date Acquired			**05/15/91**
Date of Sale / Distribution			12/01/15
Date first a PFIC			**8/1/2004**
Last day of tax year prior to tax year of sale			12/31/2014
Excess distribution or gain from sale			$ 190,000.00
Total days in holding period up to date of excess distribution (Gain)			8,967
Excess distribution (Gain) per day			$ 21.18880339
Days prior to becoming a PFIC			4,827
Days in tax year of sale or distribution up to date of sale or distribution			335
Days as a PFIC up to the end of the tax year before the year of sale or distribution			3,805
Excess distribution (Gain) allocated to year or sale or distribution			$ 7,098.25
Excess distribution (Gain) allocated to years prior to first date as a PFIC			$ 102,278.35
Excess distribution (Gain) allocated to current tax year and years prior to the first year as a PFIC - **Other Income**			***$ 109,376.60***
Excess distribution (Gain) allocated to PFIC years prior to the year of sale or dividend.			$ 80,623.40
Total excess distribution (Gain)			$ 190,000.00

Example 3
Gain from sale of Gifted PFIC

Individual A			
PFIC §1291 Calculations			
Tax Year 2015			
Fund Name			PFIC
Date Acquired			**05/15/91**
Date of Sale / Distribution			12/01/15
Allocated Excess Distribution			
1/1/2014	365		7,733.91
1/1/2013	365		7,733.91
1/1/2012	366		7,755.10
1/1/2011	365		7,733.91
1/1/2010	365		7,733.91
1/1/2009	365		7,733.91
1/1/2008	366		7,755.10
1/1/2007	365		7,733.91
1/1/2006	365		7,733.91
1/1/2005	365		7,733.91
1/1/2004	366		3,241.89
1/1/2003	365		-
PFIC Years prior to transaction year			**$ 80,623.37**
Aggregate Increases in Tax			
1/1/2014	365	39.6%	3,062.63
1/1/2013	365	39.6%	3,062.63
1/1/2012	366	35.0%	2,714.29
1/1/2011	365	35.0%	2,706.87
1/1/2010	365	35.0%	2,706.87
1/1/2009	365	35.0%	2,706.87
1/1/2008	366	35.0%	2,714.29
1/1/2007	365	35.0%	2,706.87
1/1/2006	365	35.0%	2,706.87
1/1/2005	365	35.0%	2,706.87
1/1/2004	366	35.0%	1,134.66
1/1/2003	365	35.0%	-
Aggregate Increases in Tax			**$ 28,929.70**

Example 3
Gain from sale of Gifted PFIC

Individual A			
PFIC §1291 Calculations			
Tax Year 2015			
Fund Name			PFIC
Date Acquired			**05/15/91**
Date of Sale / Distribution			12/01/15
Interest			
Tax Yr	From	To	
1/1/2014	2014	2015	94.74
1/1/2013	2013	2015	190.90
1/1/2012	2012	2015	257.00
1/1/2011	2011	2015	346.35
1/1/2010	2010	2015	454.03
1/1/2009	2009	2015	574.92
1/1/2008	2008	2015	710.79
1/1/2007	2007	2015	898.65
1/1/2006	2006	2015	1,186.62
1/1/2005	2005	2015	1,502.09
1/1/2004	2004	2015	748.87
1/1/2003	2003	2015	-
Total Interest			**$ 6,964.97**

Example 3
Gain from sale of Gifted PFIC

Individual A			
PFIC §1291 Calculations			
	2015	Totals	Tax & Interest Estimate
Total gain on sale	190,000.00	190,000.00	
Other Income	$ 109,376.60	$ 109,376.60	$ 43,313.13
Aggregate Increase in Tax	$ 28,929.70	$ 28,929.70	$ 28,929.70
Interest	$ 6,964.97	$ 6,964.97	$ 6,964.97
Total estimated tax and interest			**$ 79,207.80**
Note 1 - Tax on Other Income estimated at 39.6%			

Example 4
§1296 Mark to Market

Individual C is a US citizen with an account in Switzerland into which he made regular monthly contributions from 2005 through 2015. US dollars were contributed and immediately invested in euros. Monthly investments were made in 3 foreign mutual funds treated as PFICs. Periodically, C sold shares and distributed funds, which were then converted to US dollars. No dividends were paid by the funds.

Individual C participated in the Offshore Voluntary Disclosure Program filing returns for 2005 through 2012. How are the mark to market computations made for years under the Program and subsequent years? Assume the mutual funds satisfy the definition of marketability under §1296.

What are the implications of maintaining the account in euros?

Example 4- OVDP & §1296

Individual C
Example 4
OVDP and §1296 Mark to Market Calculations

Year	Mark to Market Gain/(Loss)	Ordinary Gain/(Loss) on Sales	Total Ordinary Income/(Loss)	20% Tax (OVDP)	Interest Due (OVDP)	Total Tax and Interest (OVDP)	S-T Capital Loss	L-T Capital Loss
2005	$ 129,323.20	$ 9,101.30	$ 138,424.50	$ 27,684.90		$ 27,684.90	$ (120.72)	$ -
2006	205,664.57	(2,585.72)	203,078.85	40,615.77	-	40,615.77	-	(9,454.27)
2007	(258,178.80)	(2,662.18)	(260,840.98)	(52,168.20)	-	(52,168.20)	-	(5,262.62)
2008	2,525,654.44	21,021.56	2,546,676.00	509,335.20	-	509,335.20	-	-
2009	1,108,139.71	16,758.99	1,124,898.70	224,979.74	-	224,979.74	-	-
2010	(3,645,389.95)	(31,137.92)	(3,676,527.87)	(735,305.57)	-	(735,305.57)	-	(37,243.28)
2011	1,434,055.97	28,326.46	1,462,382.43	292,476.49	-	292,476.49	-	-
2012	(678,148.35)	(27,580.66)	(705,729.01)	(141,145.80)	-	(141,145.80)	-	(5,848.37)
2013	-	-	-	-	-	-	-	(69,082.32)
2014	814,802.54	56,954.52	871,757.06	-	-	-	-	(44.69)
2015	(511,870.61)	-	(511,870.61)	-	-	-	-	-
Totals	**$ 1,124,052.72**	**$ 68,196.35**	**$ 1,192,249.07**	**$ 166,472.53**	**$ -**	**$ 166,472.53**	**$ (120.72)**	**$ (126,935.55)**

Example 4 - §1296 Only

Individual C
Example 4
§1296 Mark to Market Calculations

Year	Mark to Market Gain/(Loss)	Ordinary Gain/(Loss) on Sales	Total Ordinary Income/(Loss)	20% Tax (OVDP)	Interest Due (OVDP)	Total Tax and Interest (OVDP)	S-T Capital Loss	L-T Capital Loss
2005	$ 129,323.20	$ 9,101.30	$ 138,424.50	$ -	$ -	$ -	$ (120.72)	$ -
2006	205,664.57	(2,585.72)	203,078.85	-	-	-	-	(9,454.27)
2007	(258,178.80)	(2,662.18)	(260,840.98)	-	-	-	-	(5,262.62)
2008	2,525,654.44	21,021.56	2,546,676.00	-	-	-	-	-
2009	1,108,139.71	16,758.99	1,124,898.70	-	-	-	-	-
2010	(3,645,389.95)	(31,137.92)	(3,676,527.87)	-	-	-	-	(37,243.28)
2011	1,434,055.97	28,326.46	1,462,382.43	-	-	-	-	-
2012	(678,148.35)	(27,580.66)	(705,729.01)	-	-	-	-	(5,848.37)
2013	(650,393.15)	(35,530.85)	(685,924.00)	-	-	-	-	(33,551.49)
2014	1,399,262.75	122,887.52	1,522,150.27	-	-	-	-	(44.69)
2015	(691,687.81)	-	(691,687.81)	-	-	-	-	-
Totals	**$ 878,302.58**	**$ 98,598.50**	**$ 976,901.08**	**$ -**	**$ -**	**$ -**	**$ (120.72)**	**$ (91,404.72)**

Example 4 – FX Gain/(Loss)

Individual C			
FX Gain/(Loss) Summary			
Year	Foreign Currency Gain	Withdrawals	Deposits
2005	(20,450.87)	368,685.43	3,422,495.01
2006	19,414.04	494,380.21	3,420,228.95
2007	35,579.14	543,731.65	3,734,449.33
2008	(45,003.43)	819,879.45	4,036,736.88
2009	43,531.00	558,859.33	3,802,132.99
2010	(31,214.73)	542,655.45	3,631,073.80
2011	(22,975.18)	555,420.33	3,703,477.78
2012	(7,446.13)	518,101.46	3,382,041.67
2013	(12,995.42)	526,588.73	3,461,201.22
2014	12,129.82	743,850.07	3,484,165.96
2015	6,429.83	300,048.02	1,303,912.09
Total	**(23,001.93)**	**5,972,200.13**	**37,381,915.68**

Example 5
Return of Capital - §1291 Fund

Individual B has held an investment in a foreign corporation treated as a PFIC for many years. The corporation has paid out a relatively level stream of distributions each year. However, in 2015 and 2016 considerably larger distributions were made. For 2015 and 2016 the corporation did not have any current or accumulated earnings and profits.

How are the distributions taxed?

Example 5
Return of Capital - §1291 Fund

Individual B				
PFIC Distribution Analysis and §1291 Calculation				
Form 8621; Part V; Line 15				
1	**Analysis Year**		**2015**	**2016**
2	Fund name		PFIC 2	PFIC 2
3	Date acquired		1/1/2009	1/1/2009
4	Year acquired		2009	2009
5	Date of current year distribution		8/1/2015	8/1/2016
6	Distribution paid to the Taxpayer	1st Yr Back	15,000.00	42,000.00
7	Distribution paid to the Taxpayer	2nd Yr Back	14,600.00	15,000.00
8	Distribution paid to the Taxpayer	3rd Yr Back	16,600.00	14,600.00
9	Sum of 3 prior years distributions		46,200.00	71,600.00
10	Less: portion of such amount not taxed in prior years			
11	under section 1291(a)(1)(B)--i.e., portion of prior 3 yrs distribtions			
12	that were excess distribtutions allocated to taxable years as a PFIC			
13	other than the year of distribution.		-	(20,734.30)
14	Net sum of 3 prior years distributions	Line 15b; 8621	46,200.00	50,865.70
15	Divisor (Max 3)		3	3
16	Base period average	Line 15c; 8621	15,400.00	16,955.23
17	Factor		125%	125%
18	125% of the 3-year average (Threshold for			
19	determination of Excess Distribution)	Line 15d; 8621	19,250.00	21,194.04
20	Total 1291 Fund distributions for current year	Line 15a; 8621	42,000.00	28,000.00

Example 5
Return of Capital - §1291 Fund

Individual B				
PFIC Distribution Analysis and §1291 Calculation				
Form 8621; Part V; Line 15				
1	**Analysis Year**		**2015**	**2016**
2	Fund name		PFIC 2	PFIC 2
3	Date acquired		1/1/2009	1/1/2009
4	Year acquired		2009	2009
5	Date of current year distribution		8/1/2015	8/1/2016
21	Excess distribution related to current year distribution	Line 15e; 8621	22,750.00	6,805.96
22	Nonexcess Distribution (Prop. Reg. 1.1291-2(c)(2) - Taxable to extent provided under §301		19,250.00	21,194.04

Example 5
Return of Capital - §1291 Fund

Individual B			
PFIC Distribution Analysis and §1291 Calculation			
Tax Year 2015			
Fund Name			PFIC 2
Date Acquired			**01/01/09**
Date of Sale / Distribution			08/01/15
Date first a PFIC			1/1/2009
Last day of tax year prior to tax year of sale or distribution			12/31/2014
Excess distribution or Gain from sale			$ 22,750.00
Total days in holding period up to date of excess distribution (Gain)			2,404
Excess distribution (Gain) per day			$ 9.46339434
Days prior to becoming a PFIC			-
Days in tax year of sale or distribution up to date of sale or distribution			213
Days as a PFIC up to the end of the tax year before the year of sale or distribution			2,191
Excess distribution (Gain) allocated to year or sale or distribution			$ 2,015.70
Excess distribution (Gain) allocated to years prior to first date as a PFIC			$ -
Excess distribution (Gain) allocated to current tax year and years prior to the first year as a PFIC - **Other Income**			***$ 2,015.70***
Excess distribution (Gain) allocated to PFIC years prior to the year of sale or dividend.			$ 20,734.30
Total excess distribution (Gain)			$ 22,750.00

STEP USA

ADVISING FAMILIES ACROSS GENERATIONS

Example 5
Return of Capital - §1291 Fund

Individual B				
PFIC Distribution Analysis and §1291 Calculation				
Tax Year 2015				
Fund Name				PFIC 2
Date Acquired				**01/01/09**
Date of Sale / Distribution				08/01/15
<u>Allocated Excess Distribution</u>				
	1/1/2014	365		3,454.14
	1/1/2013	365		3,454.14
	1/1/2012	366		3,463.60
	1/1/2011	365		3,454.14
	1/1/2010	365		3,454.14
	1/1/2009	365		3,454.14
	1/1/2008	366		-
PFIC Years prior to transaction year				**$ 20,734.30**
<u>Aggregate Increases in Tax</u>				
	1/1/2014	365	39.6%	1,367.84
	1/1/2013	365	39.6%	1,367.84
	1/1/2012	366	35.0%	1,212.26
	1/1/2011	365	35.0%	1,208.95
	1/1/2010	365	35.0%	1,208.95
	1/1/2009	365	35.0%	1,208.95
	1/1/2008	366	35.0%	-
Aggregate Increases in Tax				**$ 7,574.79**

STEP USA

ADVISING FAMILIES ACROSS GENERATIONS

Example 5
Return of Capital - §1291 Fund

Individual B			
PFIC Distribution Analysis and §1291 Calculation			
Tax Year 2015			
Fund Name			PFIC 2
Date Acquired			**01/01/09**
Date of Sale / Distribution			08/01/15
Interest			
Tax Yr	From	To	
1/1/2014	2014	2015	42.32
1/1/2013	2013	2015	85.26
1/1/2012	2012	2015	114.78
1/1/2011	2011	2015	154.69
1/1/2010	2010	2015	202.78
1/1/2009	2009	2015	256.77
1/1/2008	2008	2015	-
Total Interest			**$ 856.60**

Example 5
Return of Capital - §1291 Fund

Individual B	
PFIC Distribution Analysis and §1291 Calculation	
Tax Year 2016	
Fund Name	PFIC 2
Date Acquired	01/01/09
Date of Sale / Distribution	08/01/16
Date first a PFIC (defaults to Date Acquired)	1/1/2009
Last day of tax year prior to tax year of sale or distribution	12/31/2015
Excess distribution or Gain from sale	$ 6,805.96
Total days in holding period up to date of excess distribution (Gain)	2,770
Excess distribution (Gain) per day	$ 2.45702467
Days prior to becoming a PFIC	-
Days in tax year of sale or distribution up to date of sale or distribution	214
Days as a PFIC up to the end of the tax year before the year of sale or distribution	2,556
Excess distribution (Gain) allocated to year or sale or distribution	$ 525.80
Excess distribution (Gain) allocated to years prior to first date as a PFIC	$ -
Excess distribution (Gain) allocated to current tax year and years prior to the first year as a PFIC - **Other Income**	***$ 525.80***
Excess distribution (Gain) allocated to PFIC years prior to the year of sale or dividend.	$ 6,280.16
Total excess distribution (Gain)	$ 6,805.96

Example 5
Return of Capital - §1291 Fund

Individual B			
PFIC Distribution Analysis and §1291 Calculation			
Tax Year 2016			
Fund Name			PFIC 2
Date Acquired			01/01/09
Date of Sale / Distribution			08/01/16
Allocated Excess Distribution			
1/1/2015	365		896.81
1/1/2014	365		896.81
1/1/2013	365		896.81
1/1/2012	366		899.27
1/1/2011	365		896.81
1/1/2010	365		896.81
1/1/2009	365		896.81
1/1/2008	366		-
PFIC Years prior to transaction year			**$ 6,280.13**
Aggregate Increases in Tax			
1/1/2015	365	39.6%	355.14
1/1/2014	365	39.6%	355.14
1/1/2013	365	39.6%	355.14
1/1/2012	366	35.0%	314.74
1/1/2011	365	35.0%	313.88
1/1/2010	365	35.0%	313.88
1/1/2009	365	35.0%	313.88
1/1/2008	366	35.0%	-
Aggregate Increases in Tax			**$ 2,321.81**

Example 5
Return of Capital - §1291 Fund

Individual B			
PFIC Distribution Analysis and §1291 Calculation			
Tax Year 2016			
Fund Name			PFIC 2
Date Acquired			01/01/09
Date of Sale / Distribution			08/01/16
Interest			
Tax Yr	From	To	
1/1/2015	2015	2016	14.46
1/1/2014	2014	2016	25.90
1/1/2013	2013	2016	37.50
1/1/2012	2012	2016	43.83
1/1/2011	2011	2016	54.58
1/1/2010	2010	2016	67.57
1/1/2009	2009	2016	82.16
1/1/2008	2008	2016	-
Total Interest			**$ 326.01**

Example 5
Return of Capital - §1291 Fund

Individual B				
PFIC Distribution Analysis and §1291 Calculation				
Tax Year 2016				
	2015	**2016**	**Totals**	**Tax & Interest Estimate**
Total distribution	42,000.00	28,000.00	$ 70,000.00	
Other Income (See Note 1)	$ 2,015.70	$ 525.80	$ 2,541.50	$ 1,006.43
Aggregate Increase in Tax	$ 7,574.79	$ 2,321.81	$ 9,896.59	$ 9,896.59
Interest	$ 856.60	$ 326.01	$ 1,182.61	$ 1,182.61
Amount taxable as a dividend §301	None	None	None	None
Total estimated tax and interest				**$ 12,085.63**
Note 1 - Tax on Other Income estimated at 39.6%				

CFC and PFIC U.S. Reporting Obligations

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CFC and PFIC U.S. Reporting Obligations

- CFC Reporting Obligations
  - Form 5471 (if within a defined category of filers)
  - Form 926
  - Form 8938
  - FBAR (if a single U.S. shareholder owns greater than 50% - look-through rule)
- PFIC Reporting Obligations
  - Form 5471 (if within a defined category of filers)
  - Form 926
  - Form 8938
  - Form 8621

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CFCs and Foreign Corporations Form 5471

	Category 2	Category 3	Category 4	Category 5
Who	Officer or Director & US Person ("USP") acquires 10% or increases ownership 10% pts OR 953(c)	USP crosses 10% threshold or / 10% pt. change in ownership. Includes individual becoming USP.	Persons having Control (>50%)	US shareholder ("USSH") in CFC
USC §	6046	6046	6038	6038
Attribution rules	§1.6046-1(i)	§1.6046-1(i)	§318 (modified)	USSH - §958
NRA attribution	Yes	Yes	No if USP does not own any stock	No if USP does not own any stock
Exception if no ownership	N/A	Yes, if actual owner files	Yes, if actual owner files	Yes, if actual owner files

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Conclusion

- Performing the CFC/PFIC Analysis
  – Determine whether the entity is a CFC or PFIC
  – Apply the attribution rules (map it out!)
  – If in the planning stages, attempt to plan around the CFC/PFIC rules
  – Calculate the annual financial impact, consider an election
  – Annually monitor PFIC status and the U.S. reporting obligations

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Parting Words of Wisdom

"Nothing is exactly as it seems, nor is it otherwise."
~ Alan Watts

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