

*Passive Foreign Investment
Companies
(PFICs)
and
Controlled Foreign
Corporations (CFCs)*

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

PFIC Overview

The Passive Foreign Investment Company ("PFIC") rules are designed to discourage US investors from deferring tax on investment income by holding passive investments through non-US companies that do not distribute their earnings currently.

In order to accomplish this objective, the rules impose a significant additional tax burden on gains and certain dividends derived from investments in PFICs.

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PFIC Determination – IRC Sec. 1297

If the answer to either test detailed below is “yes”, it is likely that the foreign corporation is a PFIC.

Test #1: Income Test

- Does the passive income for the year equal or exceed 75%?

Test #2: Asset Test

- Are the average percentage of assets held that produce passive income (e.g. cash) at least 50%?

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Methods for Measuring Assets under the Asset Test

- **Fair Market Value**
 - (i) Publicly Traded Corporations; or
 - (ii) Not a Controlled Foreign Corporation (CFC); or
 - (iii) Adjusted Bases does not apply.

- **Adjusted Bases**
 - (i) Not Publicly Traded Corporations; or
 - (ii) CFC; or
 - (iii) Relevant election for adjusted basis is made

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PFIC Test Exceptions

- **Certain Corporations During the Start-Up Year**
 - (i) Exception for start-up companies that engage in active business operation, with passive income in the first taxable year of operations;
 - (ii) Limited guidelines under the code and regulations;
 - (iii) Not reasonably tailored to provide relief in real-life cases.

- **Certain Corporations Changing Businesses**
 - (i) Existing corporations that are in transition from one active business to another active business;
 - (ii) Not PFIC for any prior taxable year;
 - (iii) Substantially all of its passive income is attributable to proceeds from the disposition of one or more active trades or businesses; and
 - (iv) It is not a PFIC for either of its 2 subsequent taxable years.

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US Tax Consequences of PFIC Status

If a company is classified as a PFIC, its US shareholders will be subject to special tax consequences with respect to:

- (a) any “excess distribution”; and
- (b) any gain realized on the sale or other disposition of such shares.

Fund A, a US Fund, acquires stock of Company B in 2009 and does not make a relevant Election. Company B makes dividend distributions each year as detailed below:

2009 Dividend Distribution	2010 Dividend Distribution	2011 Dividend Distribution	2012 Dividend Distribution	2013 Dividend Distribution
\$100	\$100	\$100	\$100	\$125

Excess Distribution in 2013 will be \$25

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Measures to mitigate tax and interest charge

1. Qualified Electing Fund (QEF) Election
2. Mark to Market Election (MTM)

“Once a PFIC, Always a PFIC”

3. Purging elections:
 - (i) Deemed Sale Election
 - (ii) Deemed Dividend Election

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Form 8621 - Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund

Who Must File

Generally, a U.S. person that is a direct or indirect shareholder of a PFIC must file Form 8621 for each tax year that US person:

- Receives certain direct or indirect distributions from a PFIC
- Recognizes gain on a direct or indirect disposition of PFIC stock,
- Is making an election reportable in Part II of Form 8621.

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Form 8621 - Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund

Form 8621 (Rev. December 2015) Department of the Treasury Internal Revenue Service	Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund Information about Form 8621 and its separate instructions is at www.irs.gov/form8621 .	OMB No. 1545-1002 Attachment Sequence No. 69
Name of shareholder	Identifying number (see instructions)	
Number, street, and room or suite no. (If a P.O. box, see instructions.)	Shareholder tax year: calendar year 20__ or other tax year beginning __, 20__ and ending __, 20__.	
City or town, state, and ZIP code or country		
Check type of shareholder filing the return: <input type="checkbox"/> Individual <input type="checkbox"/> Corporation <input type="checkbox"/> Partnership <input type="checkbox"/> S Corporation <input type="checkbox"/> Nongrantor Trust <input type="checkbox"/> Estate Check if any Excepted Specified Foreign Financial Assets are Reported on this Form (see instructions) <input type="checkbox"/>		
Name of passive foreign investment company (PFIC) or qualified electing fund (QEF)	Employer identification number (if any)	
Address (Enter number, street, city or town, and country.)	Reference ID number (see instructions)	
	Tax year of PFIC or QEF: calendar year 20__ or other tax year beginning __, 20__ and ending __, 20__.	

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Part I Summary of Annual Information (See instructions.)

Provide the following information with respect to all shares of the PFIC held by the shareholder:

- 1 Description of each class of shares held by the shareholder: Check if shares jointly owned with spouse.
- 2 Date shares acquired during the taxable year, if applicable:
- 3 Number of shares held at the end of the taxable year:
- 4 Value of shares held at the end of the taxable year (check the appropriate box, if applicable):
(a) \$0-50,000 (b) \$50,001-100,000 (c) \$100,001-150,000 (d) \$150,001-200,000
(e) If more than \$200,000, list value:
- 5 Type of PFIC and amount of any excess distribution or gain treated as an excess distribution under section 1291, inclusion under section 1293, or inclusion or deduction under section 1296:
(a) Section 1291 \$
(b) Section 1293 (Qualified Electing Fund) \$
(c) Section 1296 (Mark to Market) \$

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Part II Elections (See instructions.)

- A** **Election To Treat the PFIC as a QEF.** I, a shareholder of a PFIC, elect to treat the PFIC as a QEF. Complete lines 6a through 7c of Part III.
- B** **Election To Extend Time For Payment of Tax.** I, a shareholder of a QEF, elect to extend the time for payment of tax on the undistributed earnings and profits of the QEF until this election is terminated. Complete lines 8a through 9c of Part III to calculate the tax that may be deferred.
- Note: If any portion of line 6a or line 7a of Part III is includible under section 951, you may not make this election. Also, see sections 1294(c) and 1294(f) and the related regulations for events that terminate this election.*
- C** **Election To Mark-to-Market PFIC Stock.** I, a shareholder of a PFIC, elect to mark-to-market the PFIC stock that is marketable within the meaning of section 1298(a). Complete Part IV.
- D** **Deemed Sale Election.** I, a shareholder on the first day of a PFIC's first tax year as a QEF, elect to recognize gain on the deemed sale of my interest in the PFIC. Enter gain or loss on line 15f of Part V.
- E** **Deemed Dividend Election.** I, a shareholder on the first day of a PFIC's first tax year as a QEF that is a controlled foreign corporation (CFC), elect to treat an amount equal to my share of the post-1986 earnings and profits of the CFC as an excess distribution. Enter this amount on line 15e of Part V. If the excess distribution is greater than zero, also complete line 16 of Part V.
- F** **Election To Recognize Gain on Deemed Sale of PFIC.** I, a shareholder of a former PFIC or a PFIC to which section 1297(d) applies, elect to treat as an excess distribution the gain recognized on the deemed sale of my interest in the PFIC on the last day of its last tax year as a PFIC under section 1297(a). Enter gain on line 15f of Part V.
- G** **Deemed Dividend Election With Respect to a Section 1297(c) PFIC.** I, a shareholder of a section 1297(c) PFIC, within the meaning of Regulations section 1.1297-3(a), elect to make a deemed dividend election with respect to the Section 1297(c) PFIC. My holding period in the stock of the Section 1297(c) PFIC includes the CFC qualification date, as defined in Regulations section 1.1297-3(d). Enter the excess distribution on line 15e, Part V. If the excess distribution is greater than zero, also complete line 16, Part V.
- H** **Deemed Dividend Election With Respect to a Former PFIC.** I, a shareholder of a former PFIC, within the meaning of Regulations section 1.1298-3(a), elect to make a deemed dividend election with respect to the former PFIC. My holding period in the stock of the former PFIC includes the termination date, as defined in Regulations section 1.1298-3(d). Enter the excess distribution on line 15e, Part V. If the excess distribution is greater than zero, also complete line 16, Part V.

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Controlled Foreign Corporation (CFCs)

Definition

A controlled foreign corporation is ***any*** foreign corporation in which:

1. More than 50 percent of the total combined voting power of all classes of stock owned by U.S. shareholders; or
2. More than 50% of the total value of the stock is owned by U.S. shareholders

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

Interaction between PFICs and CFCs

PFICs that are also CFCs

- Asset measurement using adjusted basis
- “Pop-Up” PFIC

Thank you!

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