# Focusing on PFICs

## TEI-SJSU High-Tech Tax Institute

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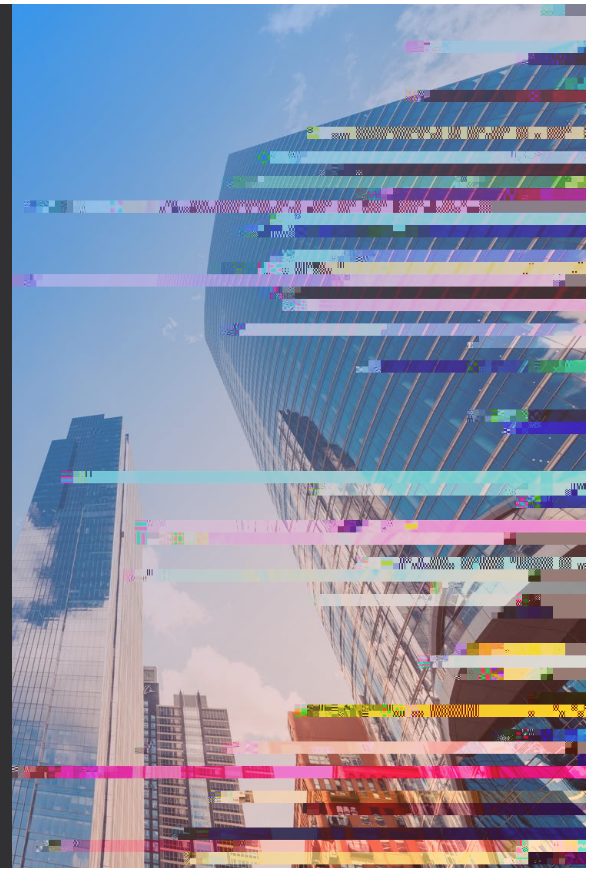
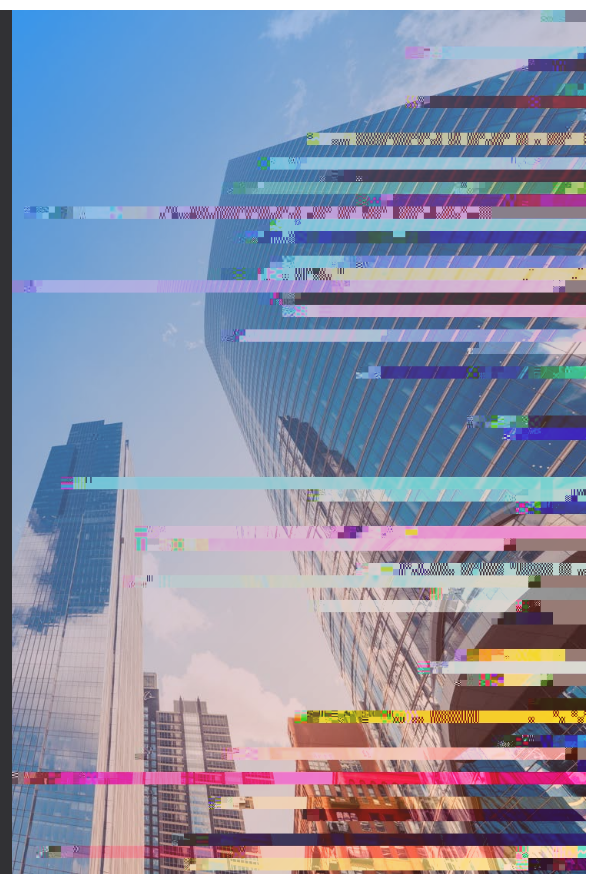


## Common Pitfalls;
## What to Do if You Find a PFIC Issue Late



# Purging Elections Overview

There are at least eight different purging elections. Two main purging elections are:

- The deemed sale election
- The deemed dividend election – available if PFIC is also a CFC

When a foreign corporation remains a PFIC, a U.S. shareholder making a purging election must make a simultaneous QEF election or qualify under the CFC overlap rule of §1297(d).

Different rules apply to inclusion shareholders of a PFIC/CFC compared to shareholders who are not inclusion shareholders.

Late QEF elections and late purging elections have their unique rules, with late QEF elections being retroactive and having strict

## Purging Election- Deemed Sale Election

- Applicable to foreign corporation that continues to be a PFIC.
- The deemed sale election treats the investor as having sold all PFIC stock at its fair market value on the "qualification date."
- Making this election results in recognizing the unrealized appreciation within the stock of unpedigreed QEF and PFIC becomes a pedigreed QEF.
- The recognized gain is taxed as an excess distribution under §1291, received on the qualification date.
- Consequently, the shareholder is liable for deferred taxes and interest on the gain from the deemed sale.
- The shareholder increases their adjusted basis in the PFIC stock by the amount of the recognized gain.
- Any realized losses on the deemed sale are not recognized and do not decrease the shareholder's adjusted basis in the PFIC stock.
- This election gives the shareholder a new holding period in the PFIC stock, effectively purging it of PFIC status.

# Purging Election- Deemed Dividend Election

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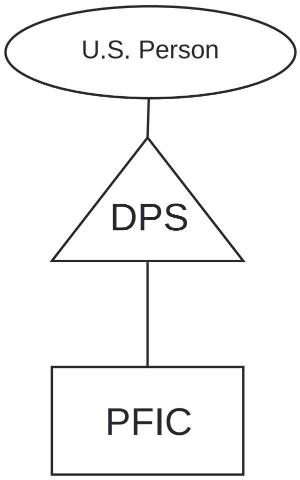
## Proposed Regulations (REG-118250-20)-An Aggregate Approach

Consistent with the aggregate approach taken in the final section 958 regulations (see TD 9960), Treasury has

# Who is the Relevant U.S. Person Under the PFIC Regime and for What Purpose?




It is important to determine who is considered a PFIC shareholder for various purposes including:

- Who is considered a shareholder for purposes of the excess distribution regime.
- Who makes a QEF election and who has the QEF inclusions.
- Who makes a MTM election and who includes/deducts the MTM amounts.
- Who makes the various purging elections under the PFIC regime.
- Who has an informational reporting obligation.

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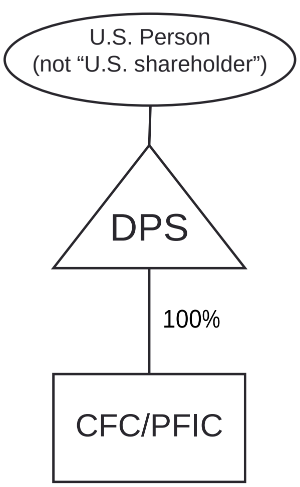
## Practical Concerns and Issues

Concerns have been expressed that the proposed regulations would expand exponentially the number of additional filings.

- Under current law, a domestic partnership can make certain PFIC elections and filings at the partnership level

# Proposed Regulations: CFC/PFIC Overlap Rule (cont.)




In the preamble to REG-118250-20, Treasury concludes that, although section 1297(d) does not define the term "shareholder" for this purpose, under Reg. §1.1291-1(b)(7), a domestic partnership or S corporation is not a shareholder to which the CFC overlap rule applies.

- Under the proposed regulations, a U.S. partner of DPS that is not a section 951(b) shareholder of the foreign corporation held by DPS does not receive the benefit of the CFC/PFIC overlap rule.
- However, as discussed below, the proposed regulations provide a transition rule that may provide some relief.

# Proposed Regulations: CFC/PFIC Overlap Rule (cont.)

Footnote 2 in the preamble notes the following:

Reg. 1.1291-1(b)(7) provides that a PFIC shareholder is a U.S. person that directly owns PFIC stock or that is an indirect shareholder under §1.1291-1(b)(8); further, it states that for purposes of sections 1291 and 1298, neither a domestic partnership nor an S corporation is treated as a PFIC shareholder, except for information reporting