

**MEMO# 31668**

March 18, 2019

# **IRS Issues Final Regulations Under Section 851 on Investments in CFCs and PFICs**

[31668]

March 18, 2019 TO: ICI Members

Tax Advisory Committee

Tax Committee SUBJECTS: Tax RE: IRS Issues Final Regulations Under Section 851 on Investments in CFCs and PFICs

The Internal Revenue Service (IRS) and the Treasury Department have released final regulations (attached) under section 851 regarding whether investments by regulated investment companies (RICs) in controlled foreign corporations (CFCs) and passive foreign investment companies (PFICs) qualify as “good income” under section 851(b) of the Internal Revenue Code. We are pleased to report that the final regulations adopt changes recommended by the Institute.[\[1\]](#)

In general, the proposed regulations would have provided that (1) inclusions from a CFC under section 951 or from a PFIC under section 1293 would be treated as “dividends” only to the extent that the CFC or PFIC had made a distribution out of its earnings and profits (the Distribution Requirement); and (2) such inclusions would not be treated as “other income” derived with respect to a RIC’s business of investing in stock, securities or currencies (the Other Income Proposal).

The final regulations adopt the Distribution Requirement. The Institute has no objections to this requirement, as it simply restates the language already set forth in the Internal Revenue Code.

The Institute strongly opposed the Other Income Proposal, which would have reclassified many inclusions from CFCs and PFICs as bad income. We believed it was unnecessary, arbitrary, and contrary to legislative intent. In consideration of our comments, the IRS and Treasury Department recognized that the Other Income Proposal would have had unintended negative effects. The final regulations thus do not include the Other Income Proposal. Further, the final regulations specify that amounts included in gross income under section 951 or section 1293 that are derived with respect to a RIC’s business of investing in stock, securities, or currencies are “other income” described in section 851(b)(2)(A). Taxpayers may rely on this qualifying income rule for taxable years that

begin after September 28, 2016.

The preamble to the final regulations also states that Revenue Rulings 2006-1 and 2006-31, and other similar guidance, will remain in effect at this time, as recommended by the Institute. The preamble does note that the IRS will continue to include the issue of whether a financial instrument or position is a security under the Investment Company Act of 1940 on its “no-rule list.” The IRS thus will not issue private letter rulings on questions relating to the treatment of a corporation as a RIC that require such a determination.

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## [Attachment](#)

### **endnotes**

[1] See Institute Memorandum No. 30493, dated December 22, 2016, which can be found at: [https://www.ici.org/my\\_ici/memorandum/memo30493](https://www.ici.org/my_ici/memorandum/memo30493).

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