

MEMO# 3970

August 3, 1992

INSTITUTE COMMENTS ON PROPOSED PASSIVE FOREIGN INVESTMENT COMPANY REGULATIONS

August 3, 1992 TO: TAX COMMITTEE NO. 30-92 INTERNATIONAL COMMITTEE NO. 16-92
ACCOUNTING/TREASURERS COMMITTEE NO. 34-92 RE: INSTITUTE COMMENTS ON
PROPOSED PASSIVE FOREIGN INVESTMENT COMPANY REGULATIONS

Attached is the Institute's comment letter on the passive foreign investment company ("PFIC") regulations that were proposed earlier this year. (See Institute Memorandum to Tax Members No. 23-92, Accounting/Treasurers Members No. 20-92, Closed-End Fund Members No. 19-92 and International Members No. 7-92, dated April 3, 1992). The Institute generally supports the proposed regulations, particularly that portion which would provide a mark-to-market election for regulated investment companies ("RICs") investing in PFICs. The letter strongly urges that the regulations be adopted in final or temporary form as soon as possible. The Institute made several technical comments on the proposed regulations. The proposed regulations appear to require that PFIC stock be marked-to-market for purposes of the excise tax provisions of Internal Revenue Code ("Code") section 4982 on December 31 of each year. Because of the potential daily fluctuations in the value of PFIC stock, it is impractical for RICs to mark their PFIC stock to market on the same day that they must declare dividends. The Institute recommended that PFICs should be marked to market on October 31, similar to the treatment of foreign currency gains, and that any mark-to-market gains arising after October 31 be treated as arising at the beginning of the next calendar year. Because of similar concerns over the practicality of distributions, the Institute also recommended that gain on actual dispositions of PFIC stock after October 31 be treated as foreign currency gain. The Institute recommended that the transition rule of the proposed regulations be modified. The current rule provides that a RIC be allowed to mark to market its accumulated unrecognized PFIC gain as of the first day of the RIC's tax year in which the proposed regulation is finalized. This rule could cause the RIC to incur an excise tax liability under Code section 4982 for the previous calendar year if the first day of the RIC's tax year is in the previous calendar year. The transition rule gain would be treated as having been realized in the previous calendar year, which could mean that the RIC would not have distributed 98% of the sum of (1) the income it previously had earned and (2) the PFIC transition rule gain. The Institute recommended that the transition rule gain be treated as arising on the first day of the calendar year in which the regulations are adopted. The Internal Revenue Service requires PFIC shareholders annually to file a Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Fund. The Institute stated that the Service should publish a list of the entities reported as PFICs on that Form.

The Institute also requested clarification that when a taxpayer is treated as owning stock of a PFIC under the "once a PFIC, always a PFIC" rule, and the foreign corporation would no longer be a PFIC under the regulations, the disposition of all of the PFIC stock halts the application of the "once a PFIC, always a PFIC" rule. Thus, the later acquisition of shares of the former PFIC by the taxpayer would not be treated as the purchase of PFIC shares. Finally, the Institute asked that (1) lending of PFIC shares in a Code section 1058 securities lending transaction not be treated as a disposition of PFIC stock, and (2) wash sales of PFIC shares be treated as stopping the holding period of the PFIC shares for purposes of determining whether the taxpayer is subject to the deferred tax on excess distribution arising from the disposition of PFIC shares. We will keep you informed of further developments. David J. Mangefrida Jr. Assistant Counsel - Tax Attachment

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