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KPMG report: Proposed passive foreign investment company (PFIC) regulations; initial impressions and observations

Proposed regulations (REG-105474-18) from the U.S. Treasury Department and IRS relating to passive foreign investment companies (PFICs) were published in the Federal Register on July 11, 2019.

Read the text of the [proposed regulations](#) [PDF 515 KB] as published in the Federal Register.

Read a [July 2019 report](#) [PDF 466 KB] prepared by KPMG LLP providing initial impressions and observations about these proposed regulations

Overview

The PFIC rules—enacted in 1986 as a counterpart to the anti-deferral regime in subpart F—target U.S. owners of foreign corporations with primarily passive income or assets. The PFIC rules, unlike the rules in subpart F, aim to remove the economic benefit of deferral with respect to all U.S. investors in a PFIC, not just those with significant ownership. Notoriously broad and complex, the PFIC rules generally discourage U.S. taxpayers from investing in PFICs—if they can identify that a foreign corporation is a PFIC in the first instance.

Generally, a PFIC is a foreign corporation that has, during the tax year, at least 75% passive income (the “Income Test”) or an average percentage of assets that produce passive income of at least 50% (the “Asset Test”). Passive income is any income of a kind that would be foreign personal holding company income (FPHCI) as defined in section 954(c), subject to certain exceptions in the PFIC rules. One such exception from the definition of passive income is income derived in the active conduct of an insurance business by a qualifying insurance corporation (QIC), as revised in the 2017 U.S. tax law (Pub. L. No. 115-97, enacted December 22, 2017, and often referred to as the “Tax Cuts and Jobs Act”).

For many years, taxpayers have relied on Notice 88-22 for crucial guidance on the application of the PFIC rules. Treasury also issued proposed regulations in 2015 on the prior version of the PFIC

insurance exception; those proposed regulations were never finalized and are withdrawn in connection with issuing the proposed rules.

The proposed rules (discussed in detail in this report include guidance on:

- The determination of ownership and attribution through partnerships
- The Income Test
- The Asset Test
- The look-through rule for 25%-owned corporations and certain domestic subsidiaries
- The change-of-business exception
- The PFIC insurance exception

Although the proposed rules address many lingering PFIC issues, they leave untouched certain other longstanding unresolved PFIC issues, including: (1) qualified electing fund guidance; (2) mark-to-market regime guidance; (3) the PFIC stock transfer non-recognition override rule under section 1291(f); and (4) ownership attribution by reason of options. Further, it is notable that the proposed rules do not mention any potential coordination with the aggregate domestic partnership approach included in the recently released subpart F proposed regulations, which appear to increase the relevance of the PFIC rules by decreasing the availability of the PFIC/controlled foreign corporation (CFC) overlap rule in certain circumstances.

These points are discussed in this report.

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