

UPDATES AND OTHER TIDBITS

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Tags

P.F.I.C.
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F.B.A.R.

PASSIVE FOREIGN INVESTMENT COMPANY: RELAXATION OF RULES APPLICABLE TO TAX- EXEMPT SHAREHOLDERS

The passive foreign investment company (“P.F.I.C.”) rules can have an adverse impact on any U.S. person that may invest in a foreign company classified as a P.F.I.C. A P.F.I.C. can include an investment in an offshore investment company that owns investment assets such as stocks and securities. While ownership by a taxable U.S. investor can produce adverse tax results, ownership by a U.S. tax-exempt entity, such as a retirement plan or an individual retirement account (“I.R.A.”), usually will not result in adverse tax results. This situation is helpful since many tax-exempt entities invest in offshore investment companies. The one exception is if the U.S. tax-exempt investor borrows money to make its investment in the P.F.I.C. then the U.S. tax exempt may recognize unrelated business taxable income (“U.B.T.I.”) from this investment. Despite its tax-exempt status, U.B.T.I. is taxable to a U.S. tax-exempt investor under Code §511.

The P.F.I.C. rules, as do many tax rules, include extensive constructive ownership rules whose purpose is to make sure that the statutory purpose behind the rules are not undercut by use of intermediate holding companies or other means. One lurking issue was whether these constructive ownership rules could possibly apply where a beneficiary of a retirement plan or I.R.A. or a shareholder of a tax-exempt entity gets a distribution from the entity that is attributed to its investment in a P.F.I.C. The I.R.S. recently issued Notice 2014-28 that alleviated this concern. As a result, a shareholder of a tax-exempt organization or a beneficiary of a tax exempt retirement plan or I.R.A. is not subject to the P.F.I.C. rules. This notice alleviates not only possible adverse tax results, but also the need to file any relevant P.F.I.C. tax forms such as Form 8621, Information Return for a shareholder of a P.F.I.C.

TAX TREATIES STILL BEING BLOCKED

In a May 7, 2014 letter, Senator Rand Paul (R-KY) stated that he would continue to block approval of tax treaties with Luxembourg, Switzerland, Chile, and Hungary. As noted in prior publications, Rand Paul cited his objections on privacy grounds. This is particularly important, e.g., with respect to the current tax treaty with Switzerland and the “tax fraud or the like” standard under Article 26 regarding exchange of information. The 2009 Protocol would make it easier for the U.S. to seek account holder information by amending Article 26 to a “may be relevant” standard which the Technical Explanation notes incorporates the standard in Code §7602.

NOT TOO BIG TO JAIL: CREDIT SUISSE

As widely reported in the press, in a video posted to the Justice Department's website, Attorney General Eric H. Holder Jr. said that no company or individual is "too big to jail." Although Holder would not name a specific target, the press linked the video to two ongoing investigations with respect to financial institutions, one relating to offshore tax evasion: Credit Suisse.⁶⁷ Still yet undeclared U.S. account holders at Credit Suisse would be wise to clean up their tax and anti-money laundering compliance obligations before the proverbial axe comes down. The Justice Department is reported to be asking for the names of "all U.S. citizens."⁶⁸

I.R.S. WILL NOT SEEK SUPREME COURT REVIEW OF TAX RETURN PREPARER REGULATIONS

The press reported that the I.R.S. let a deadline pass to seek review by the Supreme Court of the decision that overturned, on the grounds that the I.R.S. exceeding its congressional authority, the tax return preparer regulations.⁶⁹ These regulations would have required tax return preparers to pay a fee, take continuing education courses, and pass a competency test.

I.R.S. RELEASED A REFERENCE GUIDE ON THE REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (F.B.A.R.)

On April 23, 2014 the I.R.S. has released a reference guide on foreign bank accounts and financial accounts (F.B.A.R.). The guide will assist U.S. persons as well as tax professionals who prepare and electronically file F.B.A.R. reports on behalf of clients in understanding the obligation relating to F.B.A.R. filing. The guide will also assist I.R.S. examiners in their efforts to consistently and fairly administer the F.B.A.R. examination and penalty programs.

⁶⁷ See, e.g., Danielle Douglas, "No company is too big to jail, Holder says of Justice Dept. probes." *Washington Post*, May 5, 2014, available at: http://www.washingtonpost.com/business/economy/no-company-is-too-big-to-jail-holder-says-of-justice-dept-probes/2014/05/05/e133e49c-d45f-11e3-aae8-c2d44bd79778_story.html (last accessed May 15, 2014).

⁶⁸ See, e.g., Silke Koltowitz, Ed. Ruth Pitchford, "U.S. wants Credit Suisse to plead guilty in tax dispute: report," *Reuters*, May 4, 2014, available at: <http://www.reuters.com/article/2014/05/04/us-credit-suisse-idUSBREA4302A20140504> (last accessed May 15, 2014).

⁶⁹ See, e.g., Kathleen Pender, "IRS misses deadline to appeal tax preparer rules rejection," *San Francisco Chronicle*, May 14, 2014, available at: <http://www.sfchronicle.com/business/networth/article/IRS-misses-deadline-to-appeal-tax-preparer-rules-5475521.php> (last accessed May 16, 2014). See Loving, No. 13-5061 (D.C. Cir. 2/11/14), aff'g No. 1:12-cv-00385 (D.D.C. 1/18/13).

A U.S. person must file an F.B.A.R. if that person has a financial interest in or signature authority over any financial account or accounts outside of the U.S. and the aggregate maximum value of the account(s) exceeds \$10,000 at any time during the calendar year.

The guide explains who is treated as a U.S. person for purposes of the F.B.A.R. The guide provides some useful examples. One such example discusses a U.S. citizen residing outside the U.S. and electing to be treated as a tax resident of another country under a tax treaty. Nevertheless, this individual is treated as a U.S. person for purposes of the F.B.A.R. because treaties do not affect F.B.A.R. filing obligations.

The guide also explains when a U.S. person is treated as having a financial interest in or a signatory authority over an account. The guide provides examples discussing ownership on record and holding a legal title, joint ownership, and a financial interest held through ownership of entities (domestic or foreign), including trusts in which a U.S. person has an interest as a grantor or as beneficiary.

The guide also covers the recordkeeping requirements for documents relating to reportable accounts and discusses the exceptions from filing. The guide explains the civil and criminal penalties that may be assessed for noncompliance with F.B.A.R. reporting and recordkeeping requirements. Lastly, the guide includes a nine-question exercise (with answers) to test one's understanding of the general rules.

The guide can be found here:

http://www.irs.gov/pub/irs-utl/IRS_FBAR_Reference_Guide.pdf

