STRADLEY RONON

Tax Insights

A Publication of the Stradley Ronon
Tax Practice Group

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DECEMBER 9, 2020

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IRS Issues Final PFIC Ownership Regulations

The IRS has issued final regulations (TD 9936) regarding how to determine if a foreign corporation is a passive foreign investment company (PFIC) and the application and scope of certain rules that determine whether a U.S. person that indirectly holds stock in a PFIC is treated as a shareholder of the PFIC.

On July 11, 2019, the IRS published proposed regulations (REG-105474-18) under Sections 1291, 1297, and 1298 (see our prior coverage here) in the Federal Register (84 FR 33120) (the "proposed regulations" or "2019 proposed regulations"). In addition, on Oct. 2, 2019, the IRS published proposed regulations (REG-104223-18) (see our prior coverage here) relating to the repeal of Section 958(b)(4) by the 2017 Tax Cuts and Jobs Act (TCJA) (the "section 958 proposed regulations"). As in effect before its repeal, Section 958(b)(4) provided that Section 318(a)(3)(A), (B), and (C) (providing for downward attribution) was not to be applied so as to consider a U.S. person (as defined in Section 7701(a)(30)) as owning stock owned by a person who is not a U.S. person (a foreign person). After the TCJA repealed section 958(b)(4), stock of a foreign corporation owned by a foreign person could be attributed to a U.S. person under Section 318(a)(3) for various purposes, including for purposes of determining whether the foreign corporation is a controlled foreign corporation within the meaning of Section 957 (CFC). (Section references are to the Internal Revenue Code of 1986, as amended.)

The final regulations retain the basic approach and structure of the proposed regulations, with certain revisions, including the following:

- **Attribution of ownership through a partnership, S corporation, estate or trust.** The final regulations do not adopt the proposed amendments to Treasury Regulation Section 1.1291-1(b)(8)(iii), relating to pass-through entities (partnerships, S corporations, estates and nongrantor trusts).

  Proposed Regulation Section 1.1291-1(b)(8)(iii) provided that an owner of an interest in a partnership, S corporation, estate or trust (a "pass-through entity") would be treated as owning stock owned by the pass-through entity only if the pass-through owner owns 50% or more of the pass-through entity. This proposed rule was intended to ensure that the attribution rules apply consistently whether a U.S. person owns stock of a non-PFIC foreign corporation indirectly through a partnership or directly.

  A commenter noted that this rule could prevent a U.S. person from being treated as owning stock of a PFIC owned by a non-PFIC corporation, even though the U.S. person directly and indirectly owned, in the aggregate, more than 50% of the stock of the non-PFIC corporation and argued that this result was inappropriate. The IRS agreed.

- **Application of "top-down" approach.** The final regulations apply a "top-down" approach to the attribution of ownership through all tiered ownership structures.

  Proposed Regulation Section 1.1291-1(b)(8)(iii) applied the attribution rules to a tiered ownership structure involving a pass-through entity using a "top-down" approach, starting with a U.S. person and determining what stock is considered owned at each successive lower tier on a proportionate basis.

For example, U.S. individual A owns 49% of the partnership interests in a partnership that owns 95% of the stock of a tested foreign corporation (TFC). The TFC is not a PFIC but owns all the single class of stock of a PFIC. Individual A also owns the remaining 5% of the TFC stock directly. Under a "top-down" approach, individual A is deemed to hold 46.55% of the TFC's stock through the partnership and owns 5% of the TFC's stock directly. (Preamble to TD 9936)

While a commenter suggested using a "bottom-up" approach instead of the "top-down" approach, the IRS rejected this approach in the final regulations because the "bottom-up" approach may not take into account the PFIC stock that is owned through the 5% of the tested foreign corporation's stock that individual A owns directly.

The final regulations also include a new rule addressing the application of the successive application rule to tiered ownership structures. The new rule specifically provides for a top-down approach to attribution of ownership. (See Treasury Regulation Section 1.1291-1(b)(8)(iv).)

Also, the examples in the existing and proposed regulations have been revised to clarify how the top-down approach applies to those examples. (See Treasury Regulation Section 1.1291-1(b)(8)(v).) The IRS added a new example in the regulations to illustrate the operation of the successive application rule in a fact pattern in which a U.S. person owns stock of a foreign corporation both directly and indirectly through a partnership. (See Treasury Regulation Section 1.1291-1(b)(8)(v)(D).)

IRS Issues Proposed Regulations on PFICs and Depreciation Under the GILTI and FDII Rules

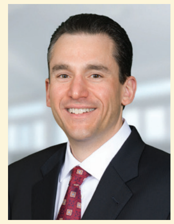
Contemporaneous with the issuance of TD 9936, the IRS also issued proposed reliance regulations (REG-111950-20) regarding (a) the determination of whether a foreign corporation is treated as a PFIC; (b) the treatment of income and assets of a qualifying insurance corporation that is engaged in the active conduct of an insurance business; and (c) the treatment of qualified improvement property under the alternative depreciation system for purposes of the global intangible low-taxed income (GILTI) and the foreign-derived intangible income (FDII) provisions.

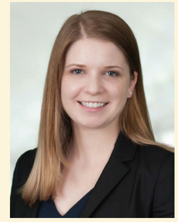
IRS Issues Guidance on Establishing Private Foundation Set-Asides

The IRS released an Issue Snapshot providing its auditors with issue indicators and audit tips for determining whether a private foundation can avoid the excise tax on undistributed income because it has established that set-asides are qualified distributions.

IRS Issues Guidance on Private Foundation Grants to Foreign Organizations

The IRS released an Issue Snapshot relating to the distribution of funds to foreign organizations to conduct activities outside of the U.S. and the special rules that a private foundation must follow when dealing with foreign organizations to avoid the excise taxes on failure to distribute income and taxable expenditures.





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Pennsylvania Extends Scholarship Credit in Response to Pandemic

Pennsylvania, in response to the Covid-19 pandemic, has provided a temporary carry forward for the tax credit for contributions from business firms to scholarship or educational improvement organizations (L. 2020, S1216 (Act. 136), effective Nov. 25). During the 2020-2021 or 2021-2022 fiscal years, any credit that cannot be used by the business firm during the fiscal year in which awarded may be carried forward and used during the two taxable years following the taxable year in which the tax credit was awarded.

New Jersey Issues Advisory on Corporation Business Tax Due Dates

The New Jersey Division of Taxation is advising corporation business taxpayers regarding changes in due dates and automatic extensions. A recently signed law provides that the return is due on the 15th day of the month following the due date of the federal return. This may impact some taxpayers' original due dates. In addition, the Division advises that the 2020 Corporation Business Tax returns (Forms CBT-100, CBT-100U, BFC-1, BFC- 1-F, and CBT-100S) are currently in the process of being updated to incorporate the new law's changes, and this is delaying the start of the filing season. As a result of this delay, taxpayers with returns that have an original due date that falls anytime between Nov. 15, 2020, and March 15, 2021, are granted an automatic extension to file their tax returns by April 15, 2021. A taxpayer will not be charged late filing penalties if the return is filed by April 15, 2021 (the extended due date). This extension applies only to the filing of the return and does not extend the time to make all required payments. Affected taxpayers that apply for an extension of time to file have six months from their original due date to file their tax returns.