

**PFIC**

Passive Foreign Investment Company

## PFIC Objectives

- ▶ Determine What is a PFIC
- ▶ Determine how to recognize a PFIC
- ▶ Describe the different tax regimes under PFIC
- ▶ Determine how distributions and dispositions of PFIC stock are taxed under IRC §1291
- ▶ Determine how the PFIC is identified on the Closing Agreement (Form 906)

## Definition of a PFIC

A foreign corporation is a PFIC if the foreign corporation meets either an asset test or an income test

- ▶ IRC §1297(a)

# Definition of a PFIC

## Passive Income Test IRC § 1297(a)(1)

- ▶ Passive income that is at least 75% of gross income in any single year
  - Passive income for purposes of determining PFIC status includes anything considered foreign personal holding company income ("FPHCI") under IRC § 954(c)
    - Interest, dividends, rents, royalties, and annuities
    - Net gain from sale of property that produces IRC § 954(c) income or no income
    - Net gains from certain foreign exchange and commodity transactions that do not arise in the ordinary course of business or out of hedging transactions
    - Income from notional principle contracts

# Definition of a PFIC

## Asset Test IRC § 1297(a)(2)

- ▶ Passive assets represent at least 50% of total assets in any single tax year
  - Whether or not an asset is “passive” is determined by whether or not the asset produces passive income or is held for the production of passive income
  - The determination of the value of the assets is based on FMV for (i) publicly traded; or (ii) non–publicly traded companies that do not make an election is made to use adjusted basis (IRC § 1297(e)(1))
  - The determination of the value of the assets is based on adjusted basis with respect to (i) Controlled Foreign Corporations (CFC); or (ii) non–publicly traded companies that elect to use adjusted basis (IRC § 1297(e)(2))

## PFIC Tax Regimes

### IRC § 1291 Fund

- ▶ An “IRC § 1291 fund” is subject to deferred taxation and an interest charge on “excess distributions”
- ▶ Default tax treatment for PFIC
- ▶ Often referred to as “statutory” method

## PFIC Tax Regimes

### QEF Election

- ▶ The IRC § 1295 QEF election requires the PFIC shareholder to be taxed on the shareholder's portion of the PFIC's ordinary earnings and net capital gains for the year
- ▶ Method must be elected no later than the due date for the return
- ▶ Late election is not allowed within OVDI program

# PFIC Tax Regimes

## **Mark to Market (MTM) Election**

- ▶ The IRC § 1296 MTM election taxes the PFIC shareholder on the annual increase in the value of the shareholders PFIC stock to the extent that the FMV of the stock at the close of the taxable year exceeds the shareholder's adjusted basis in the stock
- ▶ MTM losses can be deducted to the extent of prior income inclusions in prior years resulting from the IRC § 1296 MTM election
- ▶ Method must be elected no later than the due date for filing the return
- ▶ An "alternative" method of the IRC § 1296 MTM method is allowed with in the OVDI program.



## PFIC Taxation Filing Requirements

### Prop. Reg. 1291-1(i)

- ▶ A US person that is a shareholder in a PFIC must file a Form 8621 with respect to **each** PFIC of which the person is a shareholder during a year
- ▶ Form 8621 is filled by attaching the form to the shareholder's federal income tax return for the year
- ▶ If the PFIC shareholder is not required to file an income tax return, then Form 8621 must be filed in Philadelphia.

## How to Recognize PFIC

- ▶ Taxpayer invests in investment funds show on offshore bank statements
  - Foreign Mutual Funds
  - Foreign Currency Funds
  - Money Market Funds
  - Equity Bonds
- ▶ The terms “SICAV” and “ICVC” appear after the name of the fund or the term “Certificate” in the name description
- ▶ Look at statements and look for situations where taxpayer is purchasing “Units” of funds
- ▶ Three digit country code appears in the name description; i.e. (LUX)
- ▶ PFIC are not traded on U.S. exchanges.

## Discussion Questions

Q: Define PFIC?

A: A foreign corporation that meets either an asset test or an income test.

Q: A foreign corporation is a PFIC if the foreign corporation has passive income that is at least \_\_\_\_\_ of gross income in any single year.

A: 75%

Q: A foreign corporation is a PFIC if the foreign corporation has passive assets representing at least \_\_\_\_\_ of total assets in any single year.

A: 50%

## Discussion Questions

- ▶ Q: Provide examples of “passive income” for purposes of determining PFIC status.
- ▶ A: Interest, dividends, rents, royalties, and annuities. Net gain from sale of property that produces IRC § 954(c) income or no income. Net gains from certain foreign exchange and commodity transactions that do not arise in the ordinary course of business or out of hedging transactions. Income from notional principle contracts.
- ▶ Q: True or False a taxpayer can elect to treat PFIC under the QEF method within the OVDI program.
- ▶ A: False

## Discussion Questions

- ▶ Q: What are some indicators that an item might be a PFIC?
- ▶ A: The item is a fund, has SICAV or ICVC included in fund name, fund is denoted in units, or a three digit country code appears in the name.

▶ SECTION 1291 PFIC

## Section 1291 PFIC

An IRC §1291 fund is subject to the deferred taxation and an interest charge on “excess distributions”

## Section 1291 PFIC

What are “excess distributions”?

- ▶ IRC §1291(b), Prop Reg. 1.1291-2(c)
- ▶ In most instances for OVDI purposes, excess distributions come about upon the sale of a PFIC or PFIC stock. Any gain on the sale represents a current year distribution, which is characterized as an excess distribution.
- ▶ Losses can not be recognized from the disposition of PFIC or PFIC stock (Prop. Regs. 1.1291-3 and 1.1291-6). Losses are therefore recognized under the normal capital loss rules of the code.



## Sec 1291 PFIC

### Taxation of Excess Distribution

- ▶ Prop. Reg. 1.1291-2(e)
- ▶ The excess distribution is allocated pro-rata to each day of the PFIC shareholders holding period
  - The portion allocated to the current year is taxed in the current year of the distribution
  - The portion of the distribution allocated to the PFIC holding period years is subject to the deferred tax at IRC §1291(c)
- ▶ The deferred tax is:
  - Calculated without any deductions
  - Calculated at the highest ordinary income rate applicable
  - Added to tax due in the current year, with interest due from the due date of the return for the allocation year until the due date for the current year.

# Section 1291 PFIC Example

## Disposition of Sec 1291 PFIC

### Facts:

- ▶ 1/1/2001: Purchase PFIC for \$10,000
- ▶ 12/31/2004: Sale of PFIC for \$60,000
- ▶ Gain on Sale of PFIC = \$50,000
  - The entire amount is treated as Excess Distribution

### Gain on Sale Taxed as Excess Distribution

- ▶ Calculation of Deferred tax and interest:
  - 2001:  $\$12,500 \times 39.1\% = \$4,888 + \$791$  (3 years of interest)
  - 2002:  $\$12,500 \times 38.6\% = \$4,825 + \$470$  (2 years of interest)
  - 2003:  $\$12,500 \times 35.0\% = \$4,375 + \$214$  (1 year of interest)
- ▶ Current Gross Income:
  - 2004: \$12,500 ordinary income

## Section 1291 PFIC Ex Continued

Tax Consequences in 2004:

- ▶ Ordinary income of \$12,500
- ▶ Deferred Tax = \$14,088
- ▶ Deferred Interest = \$1,475

## Section 1291 PFIC Example

### Facts:

- ▶ 4/1/2001: Purchase PFIC for \$35,000
- ▶ 11/30/2006: Sale of PFIC for \$80,000
- ▶ Gain on Sale of PFIC = \$45,000
- ▶ PFIC was held for 2,069
  - 274 days in 2001
  - 365 days each in years 2002, 2003, 2005
  - 366 days in year 2004 (leap year)
  - 334 days in 2006

### Calculation of Excess Distribution

- ▶ 2001:  $(\$45,000 \text{ gain} / 2,069 \text{ days held}) \times 274 \text{ days held during year} = \$5,959$
- ▶ 2002, 2003, 2005:  $(\$45,000 \text{ gain} / 2,069 \text{ days held}) \times 365 \text{ days held during year} = \$7,939$
- ▶ 2004:  $(\$45,000 \text{ gain} / 2,069 \text{ days held}) \times 366 \text{ days held during year} = \$7,960$
- ▶ 2006:  $(\$45,000 \text{ gain} / 2,069 \text{ days held}) \times 334 \text{ days held during year} = \$7,264$

## Section 1291 PFIC Ex Continued

### Gain on Sale Taxed as Excess Distribution

- ▶ Calculation of Deferred tax and Interest
  - 2001:  $\$5,959 \times 39.1\% = \$2,330 + \$795$  (5 Years interest)
  - 2002:  $\$7,939 \times 38.6\% = \$3,064 + \$817$  (4 Years interest)
  - 2003:  $\$7,939 \times 35.0\% = \$2,779 + \$585$  (3 Years interest)
  - 2004:  $\$7,960 \times 35.0\% = \$2,786 + \$429$  (2 Years interest)
  - 2005:  $\$7,939 \times 35.0\% = \$2,779 + \$225$  (1 Year interest)
  
- ▶ Current gross income
  - 2006: \$7,264 ordinary income

### Tax Consequences in 2006:

Ordinary Income of \$7,264  
Deferred Tax = \$13,738  
Deferred interest = \$2,851

# Section 1291 PFIC on Form 906

## Form 906 Presentation

1. This agreement applies to Taxpayer's additional tax liability relating to the Taxpayer's voluntary disclosure of foreign source assets and income made to the Internal Revenue Service pursuant to the Voluntary Disclosure Practice relating to offshore issues that was announced on January 9, 2012. Taxpayer had additional unreported income during through relating to the voluntary disclosure as follows:

| Item/Issue | 2003 | 2004 | 2005 | 2006     | 2007 | 2008 | 2009 | 2010 |
|------------|------|------|------|----------|------|------|------|------|
| PFIC Gains | \$0  | \$0  | \$0  | \$45,000 | \$0  | \$0  | \$0  | \$0  |

2. During the period 2003 through 2010, Taxpayer invested in one or more Passive Foreign Investment Companies (PFICs) within the meaning of IRC Section 1297(a). Of the unreported income in paragraph 1 above, the following amounts constituted an excess distribution and/or gain on the disposition of PFIC stock subject to the tax treatment imposed by section 1291.

| Item/Issue  | 2003 | 2004 | 2005 | 2006     | 2007 | 2008 | 2009 | 2010 |
|-------------|------|------|------|----------|------|------|------|------|
| PFIC Income | \$0  | \$0  | \$0  | \$37,736 | \$0  | \$0  | \$0  | \$0  |

## Section 1291 PFIC on Form 906

Amount to include in the table located in paragraph 1 of the Form 906

- ▶ Gain from the disposition of IRC §1291 Fund
  - Gain on sale of PFIC
    - Gains only. NO LOSSES
- ▶ Amount to include in table from the additional PFIC paragraph of the Form 906 (PFIC Income)
  - Gain on sale of PFIC less Ordinary income
  - \$45,000 gain – \$7,264 ordinary income = \$37,736

## Section 1291 PFIC in RGS

### Ordinary Income

- ▶ Reported on page 1 of the 1040 as other income.
  - Create other income issue. Rename issue Current Year PFIC Income. Categorize issue as other income.
  - Adjustment from our example is \$7,264

### Deferred Tax

- ▶ Write in amount included in the total tax on page 2 of the 1040.
  - Create Section 1291 Tax Issue (See RGS Issue Reference Guide)
  - Categorize issue as Section 1291 taxes
  - Adjustment from our example is \$13,738

### PFIC Interest

- ▶ Reported as a footnote on Form 1040. Some preparers include this amount in the Other Taxes Section of the 1040.
  - Create Section 1291 Interest issue (See RGS Issue Reference Guide)
  - Categorize issue as other taxes
  - Adjustment from our example is \$2,851



## Section 1291 PFIC Ex Continued

Assume same facts as previous example on slide 19 except the PFIC was sold for \$30,000

- ▶ The PFIC is sold at a loss of \$5,000.
  - There are no excess distributions
  - There is no current year ordinary income
  - The loss is reported on the Sch D using the capital loss rules of the code.
  - Losses are not included with the Form 906 PFIC Income/Gain items

## Section 1291 PFIC Review

- ▶ Section 1291 method is the default method unless taxpayer makes election to treat differently
- ▶ Gains on sale of units are treated as excess distributions under IRC §1291
- ▶ Allocate excess distributions over holding period of PFIC
- ▶ Allocated gain to current year treated as ordinary income
- ▶ Allocated gain to prior years subject to deferred tax and deferred interest charge

## Section 1291 PFIC Practice

- ▶ Introduce Sec 1291 PFIC workbook
- ▶ Work Group Example
- ▶ Work Example Individually

- ▶ **ALTERNATIVE MARK-TO-MARKET**
  - ▶ **(AMTM)**

## AMTM

- ▶ Special PFIC MTM only for OVDI cases
- ▶ Described in FAQ 10 of the OVDI program
- ▶ Service offers this method due to lack of historical information on the cost basis and holding period of many PFIC investments
  - Making Section 1291 computations difficult
- ▶ Taxpayer **must** make an election to receive AMTM treatment.
- ▶ Taxpayers who elect to use the AMTM method must calculate the gain or loss on every PFIC investment held using this method

## AMTM

- ▶ A tax rate of 20% will be applied to the MTM gain(s), MTM net gain(s) and gain from all PFIC disposition during the OVDI period, in lieu of the rate contained in the Code for the amount allocable to the current year and for the deferred tax amount(s) allocable to any other tax year
- ▶ A rate of 7% of the tax computed for PFIC investments marked to market in the first year of the OVDI application will be added to the tax for that year in lieu of the interest charge mechanism described in the Code.

## AMTM

MTM losses will be limited to unreversed inclusions

- ▶ Generally, unreversed inclusions are previously reported MTM gains less previously allowed MTM losses
- ▶ During the OVDI period, MTM losses will be treated as ordinary losses (IRC §1296(c)(1)(B)) and the tax benefit is limited to the tax rate applicable to the MTM gains derived during the OVDI period
- ▶ Calculated on a share by share basis in the same manner as IRC §1296

## AMTM Example

### Facts:

- ▶ ABC Money Market Fund held prior to 1/1/2003
- ▶ Purchased fund on 1/1/1998 for \$10,000
- ▶ Sold fund on 2/5/2006 for \$50,000
- ▶ FMV:
  - 12/31/2003 is \$15,000
  - 12/31/2004 is \$8,000
  - 12/31/2005 is \$18,000



# AMTM Example Continued

## Computation

| Year | Adjusted Basis | Sale or MTM Price | Realized Gain/Loss | Unreversed Inclusions | Recognized Gain/Loss | Adj Basis for Next Yr |
|------|----------------|-------------------|--------------------|-----------------------|----------------------|-----------------------|
| 2003 | \$10,000       | \$15,000          | \$5,000            | \$5,000               | \$5,000              | \$15,000              |
| 2004 | \$15,000       | \$8,000           | (\$7,000)          | \$0                   | (\$5,000)            | \$10,000              |
| 2005 | \$10,000       | \$18,000          | \$8,000            | \$8,000               | \$8,000              | \$18,000              |
| 2006 | \$18,000       | \$50,000          | \$32,000           |                       | \$32,000             |                       |

- ▶ Adjusted basis= Purchase price in initial year and adjusted basis for subsequent years
- ▶ Sale/MTM price = FMV in years held, sale price in years sold
- ▶ Realized Gain/Loss = Sale/MTM price - Adjusted basis
- ▶ Unreversed inclusions = Previously reported MTM gains - Previously allowed MTM Losses
- ▶ Recognized Gain/Loss = Amount of gain/loss recognized. Note losses are only recognized to extent of unreversed inclusions
- ▶ Adj. Basis for Next Yr. = Adjusted Basis + Recognized Gain/Loss

# AMTM Example Continued

## Tax Consequences

| Year | Recognized Gain/Loss | Alternative Tax Rate | Alternative Tax | Alternative Interst (7%) |
|------|----------------------|----------------------|-----------------|--------------------------|
| 2003 | \$5,000              | 20%                  | \$1,000         | \$70                     |
| 2004 | (\$5,000)            | 20%                  | (\$1,000)       |                          |
| 2005 | \$8,000              | 20%                  | \$1,600         |                          |
| 2006 | \$32,000             | 20%                  | \$6,400         |                          |

- ▶ Underpayment interest and penalties on the deficiency are computed in accordance with the Code and the terms of the OVDI program
- ▶ For any PFIC investment retained beyond the final year of the OVDI program, the taxpayer must continue using the MTM method, but will apply the normal statutory rules of IRC §1296, and well as the provisions of IRC §1291-1298, as applicable

# AMTM Form 906

## ▶ Form 906 Presentation

2. Taxpayer hereby makes, and the IRS agrees to accept, a late election under section 1296 to adopt the mark to market method for calculating tax on all PFIC investments held during the period 2003 through 2010.

3. In addition to the unreported income and deductions in paragraph 1, the following amounts represent additional income and deductions related to the PFIC investments:

| Item/Issue  | 2003    | 2004      | 2005    | 2006     | 2007 | 2008 | 2009 | 2010 |
|-------------|---------|-----------|---------|----------|------|------|------|------|
| PFIC Income | \$5,000 | (\$5,000) | \$8,000 | \$32,000 | \$0  | \$0  | \$0  | \$0  |

The tax on the income from the PFIC investments, including PFIC interest, is as follows:

| Item/Issue | 2003    | 2004      | 2005    | 2006    | 2007 | 2008 | 2009 | 2010 |
|------------|---------|-----------|---------|---------|------|------|------|------|
| PFIC Tax   | \$1,070 | (\$1,000) | \$1,600 | \$6,400 | \$0  | \$0  | \$0  | \$0  |

The tax on the PFIC investments (including PFIC interest) is in addition to the income tax to be calculated on the remainder of the unreported income in paragraph 1, above.

As of the end of taxable year 2010, there are no unreversed inclusions as defined by Internal Revenue Code section 1296(d) with respect to the PFIC investments.

## AMTM Form 906

- ▶ Paragraph 2 contains language allowing the taxpayer to make a late MTM election
- ▶ PFIC Income Table
  - Realized gain/loss for each year
- ▶ PFIC Tax Table
  - First year is PFIC tax determined plus interest determined
  - All subsequent years are PFIC tax determined.
  - With the exception of the first year, tax should be 20% of the income.
- ▶ Note paragraph 3 informs the taxpayer that there are NO unreversed inclusions after the OVDI period.

## AMTM in RGS

- ▶ **MTM Tax**
  - Generally included in Total Tax on 1040 as a write in item
  - Create Other Tax Issue and rename MTM Tax (See RGS Issue Reference Guide)
  - Categorize as MTM Tax
  - Enter **ONLY** tax in adjustment. Do not enter PFIC interest
- ▶ **MTM Interest**
  - Generally included in Total Tax on 1040 as write in item
  - Create Other Tax Issue and rename PFIC Interest (See RGS Reference Guide)
  - Categorize as MTM Tax
  - Enter PFIC interest for initial year

## AMTM Practice

- ▶ Introduce 1296 Workbook
- ▶ Work Group Example
- ▶ Work Example Individually

## AMTM Example – Multiple Lots / Partial Sales

- ▶ AMTM is calculated on a by share basis in the same manor as IRC §1296
- ▶ Multiple lots are when a taxpayer purchases the same fund on multiple dates.
- ▶ Multiple lots introduce various challenges
  - Different per unit basis
  - Different unreversed inclusions per unit
- ▶ Multiple lots means bifurcation
- ▶ Partial Sales introduce various challenges
  - Split basis between units held and units sold
  - Split unreversed inclusions between units held and units sold

## AMTM Example – Multiple Lots/Partial Sales

### Facts:

- ▶ Program years are 2004 through 2011
- ▶ Purchased 10 Units of ABC Money Market Fund on 1/1/2002 for \$15,000
- ▶ Sold 5 units on 10/31/2005 for \$4,000
- ▶ Purchased 15 units of ABC Money Market Fund on 3/1/2006 for \$20,000
- ▶ Sold 15 units on 6/20/2008 for \$25,000
- ▶ Sold 5 units on 12/31/2009 for \$5,000
- ▶ FMV:
  - 12/31/2004 – \$20,000
  - 12/31/2005 – \$7,500
  - 12/31/2006 – \$37,000
  - 12/31/2007 – \$27,000
  - 12/31/2008 – \$10,000



# AMTM Example – Multiple Lots / Partial Sale

| ABC Fund - 5 Units Purchased 01/01/02  |                |                   |                    |                       |                      |                       |              |
|--|----------------|-------------------|--------------------|-----------------------|----------------------|-----------------------|--------------|
| Year                                   | Adjusted Basis | Sale or MTM Price | Realized Gain/Loss | Unreversed Inclusions | Recognized Gain/Loss | Adj Basis for Next Yr | Capital Loss |
| 2004                                   | \$7,500        | \$10,000          | \$2,500            | \$2,500               | \$2,500              | \$10,000              |              |
| 2005                                   | \$10,000       | \$4,000           | (\$6,000)          | \$0                   | (\$2,500)            | \$0                   | (\$3,500)    |
| ABC Fund - 5 Units Purchased 01/01/02  |                |                   |                    |                       |                      |                       |              |
| Year                                   | Adjusted Basis | Sale or MTM Price | Realized Gain/Loss | Unreversed Inclusions | Recognized Gain/Loss | Adj Basis for Next Yr | Capital Loss |
| 2004                                   | \$7,500        | \$10,000          | \$2,500            | \$2,500               | \$2,500              | \$10,000              |              |
| 2005                                   | \$10,000       | \$7,500           | (\$2,500)          | \$0                   | (\$2,500)            | \$7,500               |              |
| 2006                                   | \$7,500        | \$12,000          | \$4,500            | \$4,500               | \$4,500              | \$12,000              |              |
| 2007                                   | \$12,000       | \$9,000           | (\$3,000)          | \$1,500               | (\$3,000)            | \$9,000               |              |
| 2008                                   | \$9,000        | \$8,333           | (\$667)            | \$833                 | (\$667)              | \$0                   | \$0          |
| ABC Fund - 10 Units Purchased 03/01/06 |                |                   |                    |                       |                      |                       |              |
| Year                                   | Adjusted Basis | Sale or MTM Price | Realized Gain/Loss | Unreversed Inclusions | Recognized Gain/Loss | Adj Basis for Next Yr | Capital Loss |
| 2006                                   | \$13,333       | \$16,667          | \$3,334            | \$3,334               | \$3,334              | \$16,667              |              |
| 2007                                   | \$16,667       | \$12,000          | (\$4,667)          | \$0                   | (\$3,334)            | \$13,333              |              |
| 2008                                   | \$13,333       | \$16,667          | \$3,334            | \$3,334               | \$3,334              | \$0                   | \$0          |
| ABC Fund - 5 Units Purchased 03/01/06  |                |                   |                    |                       |                      |                       |              |
| Year                                   | Adjusted Basis | Sale or MTM Price | Realized Gain/Loss | Unreversed Inclusions | Recognized Gain/Loss | Adj Basis for Next Yr | Capital Loss |
| 2006                                   | \$6,667        | \$8,333           | \$1,666            | \$1,666               | \$1,666              | \$8,333               |              |
| 2007                                   | \$8,333        | \$6,000           | (\$2,333)          | \$0                   | (\$1,666)            | \$6,667               |              |
| 2008                                   | \$6,667        | \$10,000          | \$3,333            | \$3,333               | \$3,333              | \$10,000              |              |
| 2009                                   | \$10,000       | \$5,000           | (\$5,000)          | \$0                   | (\$3,333)            | \$0                   | (\$1,667)    |
| Year                                   | PFIC Income    | PFIC Tax          | PFIC Interest      | Capital Loss          |                      |                       |              |
| 2004                                   | \$5,000        | \$1,000           | \$70               | \$0                   |                      |                       |              |
| 2005                                   | (\$5,000)      | (\$1,000)         | \$0                | (\$3,500)             |                      |                       |              |
| 2006                                   | \$9,500        | \$1,900           | \$0                | \$0                   |                      |                       |              |
| 2007                                   | (\$8,000)      | (\$1,600)         | \$0                | \$0                   |                      |                       |              |
| 2008                                   | \$6,000        | \$1,200           | \$0                | \$0                   |                      |                       |              |
| 2009                                   | (\$3,333)      | (\$667)           | \$0                | (\$1,667)             |                      |                       |              |

## AMTM – Multiple Lots/Partial Sale Practice

- ▶ Work Group Example
- ▶ Work individual Example

## MTM Reduction in Tax (RIT)

- ▶ MTM Losses can not reduce tax below \$0
  - Do not offset Self Employment Tax
  - Do not offset Household Employment Tax
- ▶ If MTM Loss can not be fully absorbed in year its generated the loss is carried forward as a reduction in tax (RIT) until it is used up or the final year of the disclosure.
- ▶ If a carryforward remains after the final year the loss is carried back to the year immediately prior to the loss and then continues backward.

## MTM RIT Example

### Facts

- ▶ Taxpayer generates MTM income of \$125,000 for each tax year 2003 through 2007.
- ▶ 2008 the taxpayer generates a MTM loss of \$95,000
- ▶ 2009 the taxpayer generates a MTM loss of \$15,000
- ▶ 2010 the taxpayer generates MTM income of \$5,000
- ▶ The taxpayers 2008 tax liability is \$11,000 exclusive of any MTM tax/RIT. The taxpayer does not have SE or Household employee tax.
- ▶ The taxpayers 2009 tax liability is \$1,000 exclusive of any MTM tax/RIT. The taxpayer does not have SE or Household employee tax.
- ▶ The taxpayers 2010 tax liability is \$3,000 exclusive of any MTM tax/RIT. The taxpayer does not have SE or Household employee tax.

# MTM RIT Example

## PFIC Income/Tax per PFIC computation

|             | 2003      | 2004      | 2005      | 2006      | 2007      | 2008       | 2009       | 2010    |
|-------------|-----------|-----------|-----------|-----------|-----------|------------|------------|---------|
| PFIC Income | \$125,000 | \$125,000 | \$125,000 | \$125,000 | \$125,000 | (\$95,000) | (\$15,000) | \$5,000 |
|             | 2003      | 2004      | 2005      | 2006      | 2007      | 2008       | 2009       | 2010    |
| PFIC Tax    | \$25,000  | \$25,000  | \$25,000  | \$25,000  | \$25,000  | (\$19,000) | (\$3,000)  | \$1,000 |

- ▶ Taxpayer has PFIC RIT of \$19,000 in 2008 but income tax of \$11,000
  - Taxpayer can only absorb \$11,000 of loss in 2008
- ▶ Taxpayer has PFIC RIT of \$3,000 in 2009 but income tax of \$1,000
  - Taxpayer can only absorb \$1,000 of loss in 2009

## MTM RIT Example

Determine resulting RIT Credit and remaining MTM loss

- ▶ RIT Credit = Realized RIT - Recognized RIT
- ▶ Remaining MTM Loss = Realized Loss - Recognized Loss
  - Recognized Loss = Recognized RIT / .20

Remaining RIT Credit:  $\$19,000 - \$11,000 = \$8,000$

Remaining MTM Loss:  $\$95,000 - (\$11,000 / .2) = \$40,000$

- ▶ Remaining amounts are carried forward to 2009

# MTM RIT Example

## PFIC Income/Tax after application of 2008 carryforward

|                    | 2003      | 2004      | 2005      | 2006      | 2007      | 2008       | 2009       | 2010    |
|--------------------|-----------|-----------|-----------|-----------|-----------|------------|------------|---------|
| <b>PFIC Income</b> | \$125,000 | \$125,000 | \$125,000 | \$125,000 | \$125,000 | (\$55,000) | (\$55,000) | \$5,000 |
|                    |           |           |           |           |           |            |            |         |
|                    |           |           |           |           |           |            |            |         |
|                    |           |           |           |           |           |            |            |         |
|                    |           |           |           |           |           |            |            |         |
| <b>PFIC Tax</b>    | \$25,000  | \$25,000  | \$25,000  | \$25,000  | \$25,000  | (\$11,000) | (\$11,000) | \$1,000 |
|                    |           |           |           |           |           |            |            |         |
|                    |           |           |           |           |           |            |            |         |
|                    |           |           |           |           |           |            |            |         |
|                    |           |           |           |           |           |            |            |         |

2009 Includes application of carryforward loss/RIT

- ▶ Taxpayer can only absorb \$1,000 of loss in 2009.
- ▶ Remaining RIT Credit:  $\$11,000 - \$1,000 = \$10,000$
- ▶ Remaining MTM Loss:  $\$55,000 - (\$1,000 / .2) = \$50,000$
- ▶ Remaining amounts are carried forward to 2010





# MTM RIT Example

## Form 906 Presentation

3. In addition to the unreported income and deductions in paragraph 1, the following amounts represent additional income and deductions related to the PFIC investments:

|             | 2003      | 2004      | 2005      | 2006      | 2007      | 2008       | 2009      | 2010       |
|-------------|-----------|-----------|-----------|-----------|-----------|------------|-----------|------------|
| PFIC Income | \$125,000 | \$125,000 | \$125,000 | \$125,000 | \$125,000 | (\$55,000) | (\$5,000) | (\$45,000) |

The tax on the income from the PFIC investments, including PFIC interest, is as follows:

|          | 2003     | 2004     | 2005     | 2006     | 2007     | 2008       | 2009      | 2010      |
|----------|----------|----------|----------|----------|----------|------------|-----------|-----------|
| PFIC Tax | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | (\$11,000) | (\$1,000) | (\$9,000) |

The tax on the PFIC investments (including PFIC interest) is in addition to the income tax to be calculated on the remainder of the unreported income in paragraph 1, above.

As of the end of taxable year 2010, there are no unreversed inclusions as defined by Internal Revenue Code section 1296(d) with respect to the PFIC investments.

4. Of the \$9,000 PFIC reduction in tax (RIT) in the 2010 year as stated in paragraph 3, \$6,000 is not fully absorbed in that year. The amount not absorbed will be carried back to prior years. The underpayment in the year to which the unabsorbed reduction in tax is carried back will be subject to penalties as described in paragraph 5 without regard to the carryback, and interest described in paragraph 7 will be calculated under the provisions of IRC section 6611(f)(1). The 2010 unabsorbed reduction in tax will be carried back to the following years in the following amounts:

|                             | 2003 | 2004 | 2005 | 2006 | 2007      | 2008 | 2009 | 2010 |
|-----------------------------|------|------|------|------|-----------|------|------|------|
| Carryback of unabsorbed RIT | \$0  | \$0  | \$0  | \$0  | (\$6,000) | \$0  | \$0  | \$0  |

## MTM RIT Example

### Other Items of Interest

- ▶ The negligence penalty is computed in the year of carryback **BEFORE** the application of the carryback.
- ▶ RGS setup for RIT issue will vary depending upon the tax situation.
  - RGS setup will be discussed on a case by case basis when RIT issue is encountered