



POINT SQUARE CONSULTING
INTERNATIONAL TAX CONSULTING AND ADVOCACY

FOREIGN TAX AND TREASURY REPORTING

Anthony Malik
Point Square Consulting
P: (770) 845-9289
F: (770) 628-0086
E: tony@pointsquaretax.com

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Marietta, Georgia 30066

Objective

Discussion regarding international tax issues that effect Americans living abroad and immigrants to the U.S. The focus of this course will be on common international tax forms and related compliance considerations.



Obligatory Items

- All “Section (§)” references are to the U.S. Internal Revenue Code of 1986, as amended, and the U.S. Department of the Treasury regulations promulgated thereunder unless stated otherwise.
- Unless stated otherwise, the term “tax” means income tax.
- Disclaimer: Information contained herein is provided solely for educational benefits. No information contained herein is to be construed as the rendering of tax, legal or other professional advice by Point Square Consulting, Inc.



Foreword

A very important aspect of U.S. tax law is that the determination of U.S. status of taxpayers is not coextensive with U.S. immigration law. Keeping with this, it is not uncommon for a foreign person, under customary immigration law, to be classified as a U.S. person under the tax law and vice versa. While this variance otherwise lends itself to some contradictory results, it is quite coherent within the contours of U.S. tax policy.

It is important for the tax professional to be aware that U.S. or foreign status is not a simple black or white issue. Rather residence has to be determined by considering the taxpayer's facts and circumstances within the constructs of the tax law. The tax treatment of international taxpayers can only be addressed post-residence determination.

The U.S. Tax Regime

- Residence based or worldwide regime
 - The U.S. taxes the income of U.S. persons worldwide
- Source based or territorial regime
 - To what extent are foreign persons taxed?
- Outbound taxation is rather all-encompassing
 - IRC § 61 – Imposition
 - IRC § 1 – Specification
- Inbound taxation is governed by a profligate set of rules
 - Basic idea: U.S. tax imposed on U.S. source income



Who is a “Resident of the U.S.?”

- Domestic tax law provides a “bright line” test under IRC § 7701(b)
 - Green card test
 - Substantial presence test
 - Special first year election
 - Exceptional cases
- Tax treaties can modify the internal revenue laws of the contracting states
 - Resolve jurisdictional overlap



Overview of Select Common International Tax Forms (Individuals)

1. FinCEN Form 114 – Foreign Bank Account Report
2. Form 8938 – Statement of Specified Foreign Assets
3. Form 8833 – Treaty Based Disclosure Position
4. Form 3520 – Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts
5. Form 3520-A – Annual Information Return of Foreign Trust With a U.S. Owner
6. Form 8621 – Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund



FinCEN Form 114, Foreign Bank Account Report (“FBAR”)

- Filing requirement - A **U.S. person** that has a **financial interest or signature authority** over **foreign financial accounts** if the aggregate value of the foreign financial accounts **exceeds \$10,000** at any time during the calendar year.
- Penalties for non-filing - \$10,000 initial penalty. Worst case scenario: Up to 50% of the highest account balance for each account, each year.
- Foreign financial accounts include things such as bank accounts, retirement/pension schemes, mutual funds, life insurance policies, money market accounts etc. (basically every type of financial account except for credit cards and bitcoins).



Form 8938, Statement of Specified Foreign Financial Assets

- Filing requirement - A **specified individual** that has an **interest in specified foreign financial assets** and the value of those assets is more than the applicable **reporting threshold**. (Does not currently apply to entities but may in the future.)
- Penalties for non-filing - \$10,000 initial penalty. \$10,000 per additional 30 days up to \$50,000.
- Reportable foreign financial assets include:
 - Foreign accounts maintained by a foreign financial institution
 - Interest in a foreign entity, i.e., corporations, partnerships, estates and trusts etc.
 - Financial instrument or contract that has an issuer or counterparty that is foreign

Form 8938 Filing Thresholds

	Living In the U.S.		Living OUTSIDE of the U.S.*	
	<u>Highest Balance</u>	<u>Year End Balance</u>	<u>Highest Balance</u>	<u>Year End Balance</u>
Unmarried OR Married Filed Separately	\$75,000	\$50,000	\$300,000	\$200,000
Married Filed Jointly	\$150,000	\$100,000	\$600,000	\$400,000





Comparison of Form 8938 and FBAR Requirements

The new Form 8938 filing requirement does not replace or otherwise affect a taxpayer's obligation to file FinCEN Form 114 (Report of Foreign Bank and Financial Accounts). Individuals must file each form for which they meet the relevant reporting threshold.

Who Must File?	Form 8938, Statement of Specified Foreign Financial Assets Specified individuals, which include U.S. citizens, resident aliens, and certain non-resident aliens that have an interest in specified foreign financial assets and meet the reporting threshold.	FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR) U.S. persons, which include U.S. citizens, resident aliens, trusts, estates, and domestic entities that have an interest in foreign financial accounts and meet the reporting threshold.
Does the United States include U.S. territories?	No	Yes, resident aliens of U.S. territories and U.S. territory entities are subject to FBAR reporting.
Reporting Threshold (Total Value of Assets)	\$50,000 on the last day of the tax year or \$75,000 at any time during the tax year (higher threshold amounts apply to married individuals filing jointly and individuals living abroad).	\$10,000 at any time during the calendar year.
When do you have an interest in an account or asset?	If any income, gains, losses, deductions, credits, gross proceeds, or distributions from holding or disposing of the account or asset are or would be required to be reported, included, or otherwise reflected on your income tax return.	Financial interest: you are the owner of record or holder of legal title; the owner of record or holder of legal title is your agent or representative; you have a sufficient interest in the entity that is the owner of record or holder of legal title. Signature authority: you have authority to control the disposition of the assets in the account by direct communication with the financial institution maintaining the account. See instructions for further details.
What is Reported?	Maximum value of specified foreign financial assets, which include financial accounts with foreign financial institutions and certain other foreign non-account investment assets.	Maximum value of financial accounts maintained by a financial institution physically located in a foreign country.
How are maximum account or asset values determined and reported?	Fair market value in U.S. dollars in accord with the Form 8938 instructions for each account and asset reported. Convert to U.S. dollars using the end of the tax year exchange rate and report in U.S. dollars.	Use periodic account statements to determine the maximum value in the currency of the account. Convert to U.S. dollars using the end of the calendar year exchange rate and report in U.S. dollars.
When Due?	By due date, including extension, if any, for income tax return.	Received by June 30 (no extensions of time granted).
Where to File?	File with income tax return pursuant to instructions for filing the return.	File electronically through FinCEN's www.fincen.gov e-filing system. The FBAR is not filed with a federal tax return.
Penalties	Up to \$10,000 for failure to disclose and an additional \$10,000 for each 30 days of non-filing after IRS notice of a failure to disclose, for a potential maximum penalty of \$50,000; criminal penalties may also apply.	If non-willful, up to \$10,000; if willful, up to the greater of \$100,000 or 50 percent of account balances; criminal penalties may also apply.

Types of Foreign Assets and Whether They are Reportable

Financial (deposit and custodial) accounts held at foreign financial institutions	Yes	Yes
Financial account held at a foreign branch of a U.S. financial institution	No	Yes
Financial account held at a U.S. branch of a foreign financial institution	No	No
Foreign financial account for which you have signature authority	No, unless you otherwise have an interest in the account as described above.	Yes, subject to exceptions.
Foreign stock or securities held in a financial account at a foreign financial institution	The account itself is subject to reporting, but the contents of the account do not have to be separately reported.	The account itself is subject to reporting, but the contents of the account do not have to be separately reported.
Foreign stock or securities not held in a financial account	Yes	No
Foreign partnership interests	Yes	No
Indirect interests in foreign financial assets through an entity	No	Yes, if sufficient ownership or beneficial interest (i.e., a greater than 50 percent interest) in the entity. See instructions for further detail.
Foreign mutual funds	Yes	Yes
Domestic mutual fund investing in foreign stocks and securities	No	No
Foreign accounts and investment assets held by foreign grantor trust or foreign-issued life insurance or annuity contract with a cash value	Yes, as to both foreign accounts and foreign non-account investment assets.	Yes, as to foreign accounts.
Foreign hedge funds and foreign private equity funds	Yes	No
Foreign real estate held directly	No	No
Foreign real estate held through a foreign entity	No, but the foreign entity itself is a specified foreign financial asset and its maximum value includes the value of the real estate.	No
Foreign currency held directly	No	No
Precious metals held directly	No	No
Personal property, held directly, such as art, antiques, jewelry, cars and other collectibles	No	No
Social Security-type program benefits provided by a foreign government	No	No

Foreign Retirement, Pension and Social Security *Type* Schemes (“Such Schemes”)

American taxpayer moves to a foreign country to work for a foreign employer. American taxpayer is given the option to enroll in an employer provided non-U.S. retirement plan. American taxpayer is in for a nasty surprise...



Tax Treatment of Such Schemes

- Tax treatment depends on the specifics of any given retirement arrangement
- Default rule: Three levels of taxation
- Treaty modifications (e.g., Canada and the U.K.)
 - Form 8833 to elect treaty-based return positions
 - \$1,000 penalty for failing to disclose



Foreign Trust Reporting for Such Schemes

- Generally foreign trusts under U.S. law (Reg. § 301.7701-4(a))
- Trust reporting via Forms 3520/3520-A (PLRs 2011-0096, 2008-07003)
- Applicable treaty articles do not prevent trust reporting
 - \$10,000 penalty per year per scheme (§ 6677)
 - Exception for foreign trust reporting provided only through specific administrative rulings (e.g., Canada)



Reinforcing Thoughts on Such Schemes

- Foreign retirement/pension schemes
 - Default U.S. tax rule: No enjoyment of tax deferral unless specified by an applicable international tax treaty
 - Trusts for U.S. tax purposes necessitating special tax reporting via Forms 3520 and 3520-A



Foreign Mutual Funds, Index Funds, Stocks and Similar Financial Accounts ("Such Financial Accounts")

- It is the IRS's position that the onerous Passive Foreign Investment Company ("PFIC") regime applies to such financial accounts (CCA 201003013)
- PFIC classification (§ 1297)
 - Income test: 75% or more of the income is passive
 - Asset test: 50% or more of the assets produce passive income



Tax Return Reporting

- Three alternative methods for PFIC income reporting via Form 8621.
 - Deferred interest charge default method (§ 1291)
 - Qualified electing fund (“QEF”) election method (§ 1295)
 - Mark-to-market (“MTM”) election method (§ 1296)



Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund

OMB No. 1545-1002
 Attachment
 Sequence No. **69**

► Information about Form 8621 and its separate instructions is at www.irs.gov/form8621.

Name of shareholder _____ Number, street, and room or suite no. (If a P.O. box, see instructions.) _____ City or town, state, and ZIP code or country _____	Identifying number (see instructions) _____ Shareholder tax year: calendar year 20 _____ or other tax year beginning _____, 20 _____ and ending _____, 20 _____
Check type of shareholder filing the return: <input type="checkbox"/> Individual <input type="checkbox"/> Corporation <input type="checkbox"/> Partnership <input type="checkbox"/> S Corporation <input type="checkbox"/> Nongrantor Trust <input type="checkbox"/> Estate Name of passive foreign investment company (PFIC) or qualified electing fund (QEF) _____	Employer identification number (if any) _____ Reference ID number (see instructions) _____ Tax year of PFIC or QEF: calendar year 20 _____ or other tax year beginning _____, 20 _____ and ending _____, 20 _____
Address (Enter number, street, city or town, and country.) _____	

Part I Summary of Annual Information (See instructions.)

Provide the following information with respect to all shares of the PFIC held by the shareholder:

- 1 Description of each class of shares held by the shareholder: _____
 Check if shares jointly owned with spouse.
- 2 Date shares acquired during the taxable year, if applicable: _____
- 3 Number of shares held at the end of the taxable year: _____
- 4 Value of shares held at the end of the taxable year (check the appropriate box, if applicable):
 (a) \$0-50,000 (b) \$50,001-100,000 (c) \$100,001-150,000 (d) \$150,001-200,000
 (e) If more than \$200,000, list value: _____
- 5 Type of PFIC and amount of any excess distribution or gain treated as an excess distribution under section 1291, inclusion under section 1293, or inclusion or deduction under section 1296:

 (a) Section 1291 \$ _____
 (b) Section 1293 (Qualified Electing Fund) \$ _____
 (c) Section 1296 (Mark to Market) \$ _____

(Page 1 only)

Part II Elections (See instructions.)

- A **Election To Treat the PFIC as a QEF.** I, a shareholder of a PFIC, elect to treat the PFIC as a QEF. Complete lines 6a through 7c of Part III.
- B **Election To Extend Time For Payment of Tax.** I, a shareholder of a QEF, elect to extend the time for payment of tax on the undistributed earnings and profits of the QEF until this election is terminated. Complete lines 8a through 9c of Part III to calculate the tax that may be deferred.
Note: If any portion of line 6a or line 7a of Part III is includible under section 951, you may not make this election. Also, see sections 1294(c) and 1294(f) and the related regulations for events that terminate this election.
- C **Election To Mark-to-Market PFIC Stock.** I, a shareholder of a PFIC, elect to mark-to-market the PFIC stock that is marketable within the meaning of section 1296(e). Complete Part IV.
- D **Deemed Sale Election.** I, a shareholder on the first day of a PFIC's first tax year as a QEF, elect to recognize gain on the deemed sale of my interest in the PFIC. Enter gain or loss on line 15f of Part V.
- E **Deemed Dividend Election.** I, a shareholder on the first day of a PFIC's first tax year as a QEF that is a controlled foreign corporation (CFC), elect to treat an amount equal to my share of the post-1986 earnings and profits of the CFC as an excess distribution. Enter this amount on line 15e of Part V. If the excess distribution is greater than zero, also complete line 16 of Part V.
- F **Election To Recognize Gain on Deemed Sale of PFIC.** I, a shareholder of a former PFIC or a PFIC to which section 1297(d) applies, elect to treat as an excess distribution the gain recognized on the deemed sale of my interest in the PFIC on the last day of its last tax year as a PFIC under section 1297(a). Enter gain on line 15f of Part V.
- G **Deemed Dividend Election With Respect to a Section 1297(e) PFIC.** I, a shareholder of a section 1297(e) PFIC, within the meaning of Regulations section 1.1297-3(a), elect to make a deemed dividend election with respect to the Section 1297(e) PFIC. My holding period in the stock of the Section 1297(e) PFIC includes the CFC qualification date, as defined in Regulations section 1.1297-3(d). Enter the excess distribution on line 15e, Part V. If the excess distribution is greater than zero, also complete line 16, Part V.
- H **Deemed Dividend Election With Respect to a Former PFIC.** I, a shareholder of a former PFIC, within the meaning of Regulations section 1.1298-3(a), elect to make a deemed dividend election with respect to the former PFIC. My holding period in the stock of the former PFIC includes the termination date, as defined in Regulations section 1.1298-3(d). Enter the excess distribution on line 15e, Part V. If the excess distribution is greater than zero, also complete line 16, Part V.

Taxation of § 1291 Funds: A Very Simplified Illustration (Loosely Based on a Very Complex Actual Case)

- Nicholas (“Nick”) K., a U.S. citizen, invests in a single foreign mutual fund during 2012.
- The mutual fund pays dividends of \$200 each during 2012 and 2013.
- Nick reports the dividends as ordinary dividends on his 2012 and 2013 Forms 1040.
- Nick sells the mutual fund at a gain in 2014 and reports the gain as a long-term gain.
- So far, so good, right?



Taxation of § 1291 Funds: International Tax Horror

- Absolutely not! He's subject to, at the very minimum, a \$10,000 penalty for FATCA and § 1298(f) noncompliance. He's separately also subject to accuracy related penalties and interest.



Taxation of § 1291 Funds: Methodology

- Correct dividend reporting
- Incorrect gain reporting
- The deferred interest charge method applies to the gain (Form 8621)
- Financial math (Basic idea):
 - Spread the gain over the entire period of PFIC ownership
 - Tax calculation based on the highest applicable rates for the year
 - Interest calculation (using variable interest rates)
 - Current day roll-forward



Electing QEF Taxation

- Election to include a pro rata share of the fund's ordinary income and capital gains (dividends are never qualified) into the owner's taxable income
- Think partnership taxation
- Greatly reduces compliance costs but only available to shareholders provided with a PFIC Annual Information Statement (Reg. § 1.1295-1(g))



(Presenter's comments and observations)

**Passive Foreign Investment Company (PFIC)
Annual Information Statement**

The amounts listed below represent your share of ordinary earnings, capital gains, distributions, and sales gain. They **are not** included in your Schedule K-1 and should be reported on Form 8621. See notes below and consult your tax advisor for additional guidance.

Name & Address of PFIC (note 1)	Taxable Year	Ordinary Earnings	Capital Gains	Distributions (note 2)	Sales Gain (note 3)
Brookfield Peterborough (UK) Limited Level 2, 40 Berkeley Square London W1J5AL, England	01/01/2012 to 12/31/2012	0	0	0	0
Peterborough (Progress Health) Holdings Limited 3 White Oak Square, London Road Swanley, Kent BR8 7AG, England	01/01/2012 to 12/31/2012	0	0	0	0
Peterborough (Progress Health) Nominee Limited 3 White Oak Square, London Road Swanley, Kent BR8 7AG, England	01/01/2012 to 12/31/2012	0	0	0	0
Peterborough (Progress Health) PLC 8 White Oak Square, London Road Swanley, Kent BR8 7AG, England	01/01/2012 to 12/31/2012	0	0	0	0
Prime Infrastructure Trust 2 Level 26, 135 King Street Sydney, NSW 2000 Australia	01/01/2012 to 12/31/2012	0	0	0	0
Depending on the election made on Form 8621 (note 4)		Report on this line of Form 8621			
Part II: QEF Election Made Part IV: QEF Election Not Made		Line 1a N/A	Line 2a N/A	Line 3b Line 10a	N/A Line 10f

Notes

(1) Each of the PFICs listed above will permit its shareholders to inspect and copy the permanent books of account, records, and such other documents maintained by the PFIC that are necessary to establish that the PFIC's ordinary earnings and net capital gains, as provided in §1293(e) of the U.S. Internal Revenue Code are computed in accordance with U.S. income tax principles.

(2) These amounts represent the cash and fair market value of other property distributed or deemed distributed by the PFIC.

(3) If you have not made a QEF election with regard to the PFICs reporting a value for Sales Gain, please see the additional information and instructions (see next page). If you have made a QEF election, these values are not applicable to you.

(4) Brookfield Infrastructure Partners, L.P. has invested directly or indirectly in passive foreign investment companies ("PFICs"). U.S. partners can simplify reporting their share of PFIC earnings by electing to treat the PFICs as "qualified electing funds" (a "QEF" election). U.S. partners make a QEF election for each PFIC using Form 8621. Each U.S. partner should consult Form 8621 instructions and their tax advisor regarding the implications of making or not making a QEF election.

If a U.S. partner makes a QEF election, each U.S. partner is required to include in income their portion of the ordinary income and capital gains of the PFIC (per the above schedule) on Form 8621. These amounts **are not** included on Schedule K-1 and should be reported on Form 8621. If a U.S. partner makes a QEF election they should include in their cost basis the amount of PFIC earnings reported on Form 8621.

U.S. partners choosing not to make a QEF election should report the information above on Form 8621 and consult their tax advisor with any additional questions.



Late QEF Elections

- The election generally must be made during the year of fund acquisition (concept of “pedigreed fund”)
- A QEF election for an unpedigreed fund also requires a deemed-sale election (“purging election”) to cleanse the PFIC taint (§ 1291(d)(2)(A)) * *Proceed with caution* *
- Gain on PFIC sale = BOY FMV – adjusted basis
- Taxpayer must recognize gain (taxed under § 1291) ; losses are disallowed
- Thereafter file Form 8621 in every subsequent year for all QEFs



Electing MTM Taxation

- The MTM election is available only for “marketable” funds
- The MTM election allows recognition of realized gains
- Gain computation: EOY FMV – BOY adjusted basis
- Income taxed at ordinary rates (2014 Form 1040, line 21)
- Losses are only allowed to the extent of “unreversed inclusions” (§ 1296(d))



Late MTM Elections

- Similar (not identical) to making a late QEF election
- Painful taxation in the year of untimely election because of the deemed-sale attributed to the EOY (versus BOY in the case of a late QEF election)
- The details are complicated. Basic idea: MTM treatment is inapplicable until the year *following* the late election whereas the default rules of § 1291 fully apply in the year of late election (Reg. § 1.1296-1(i)(2))
- Dilemma: Instructions for Form 8621 are incorrect in a late MTM election scenario, i.e., the guidance conflicts with federal law.



Reinforcing Thoughts on PFICs

- Passive Foreign Investment Companies (“PFICs”)
 - The HIRE Act in 2010 imposed the onerous PFIC reporting requirements on certain forms of foreign financial instruments namely mutual funds, index funds, money market accounts etc.
 - Three alternative methods of reporting PFIC income (i.e., default, QEF, MTM) via Form 8621. The default rules are punitive.
 - PFIC ownership through trusts is attributable to the beneficiaries.



PFIC Attribution Through Foreign Trusts

- Remember that most all foreign pension/retirement arrangements are trusts for U.S. tax purposes
- PFIC stock ownership through a trust is attributed to its beneficiaries (§ 1298(a)(3))
- Indirect ownership permits the IRS to directly tax the U.S. beneficiaries of the foreign trust (TAM 200733024)
- Introduces considerable complexity as the income effectively becomes subject to two separate tax regimes, i.e., the PFIC regime *and* Subchapter J (fiduciaries)



Coordination of Election and Attribution Rules – Presenter's Comments & Observations

[REDACTED]
EIN: [REDACTED]
Attachment to Schedule K-1

Partner Name: [REDACTED]
Partner No: 1326

Additional Partner Footnotes:

Note: [REDACTED] L.P. holds direct and/or indirect interest(s) in Passive Foreign Investment Company(s) ("PFIC(s)"). If held directly, or if held indirectly and [REDACTED] L.P. is the first U.S. shareholder, [REDACTED] L.P. has made a timely Qualified Electing Fund ("QEF") election with respect to each PFIC investment, effective for each year of ownership, and has filed the required form 8621. If held indirectly through an underlying U.S. partnership, the underlying U.S. partnership has made a timely QEF election with respect to each PFIC investment.

Each PFIC described above was acquired for cash. The first U.S. shareholder making a QEF election for a PFIC is required to include income currently under IRC section 1293 and to file form 8621. Your distributive share of such amount, if any, has been included in your schedule K-1. As a partner in a U.S. partnership that has made the QEF election and filed form 8621, your distributive share of this income is not required to be further reported on an additional form 8621. Therefore, the partnership has not provided form 8621 or the information necessary to prepare form 8621 to its partners.
Please consult your tax advisor.



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IRS Voluntary Disclosure Programs to Redress Prior-Year Noncompliance

- Offshore Voluntary Disclosure Program
- Streamlined Domestic Offshore Procedure
- Streamlined Foreign Offshore Procedure
- Delinquent International Information Return Submission Procedure
- Delinquent FBAR Submission Procedure
- Quiet disclosure (Not an IRS program per se)



Questions?

Anthony Malik, Principal Consultant
Point Square Consulting
tony@pointsquaretax.com
770-845-9289



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