AMERICANEXPAT
TAX SERVICES

Passive Foreign Investment Companies (PFICs)

First let's define a few key terms we use to explain PFICs

Passive income

Passive income for this purpose includes unearned income such as interest, dividends, rents, royalties, annuities, foreign currency gain and other types of investment income.

Mutual Funds/Exchange Traded Funds (ETFs)

Mutual funds and ETFs are managed portfolios of stocks and/or bonds. They are companies that bring together a large group of people and invest money on their behalf in these portfolios. Each investor owns shares of the mutual fund/ETF and the shares represent a portion of the holdings in the fund. When you buy a mutual fund/ETF, you are pooling your money along with other investors. You put money into a mutual fund/ETF by buying units or shares of the fund. As more people invest, the fund issues new units or shares.

What is a "PFIC"?

A PFIC is a Passive Foreign Investment Company, as defined under the US Tax Code. It is a non-U.S. (foreign) corporation whose assets or income are largely passive, and whose registration is outside the United States. The most common PFICs are foreign mutual funds (registered outside the United States). PFICs can also be found inside some foreign insurance policies and "unqualified" retirement accounts, Exchange Traded Funds (ETFs) and Real Estate Investment Trusts (REITs).

Under the Tax Code, a U.S. person who owns shares of a foreign corporation is not taxed until the corporation makes a distribution or the shares are sold. The Tax Reform Act of 1986 (TRA86) introduced the idea of "passive foreign investment companies" and created Internal Revenue Code Sections 1291-1298 in order to prevent U.S. persons from indefinitely deferring (effectively avoiding) taxes on passive income earned inside of foreign corporations.

The IRS requires annual reporting from US Persons who directly or indirectly receive distributions from, recognize gain on, are making an election for, are making a qualified election in, or who directly own PFIC investments on the last day of the tax year.

Beginning on 2013 US Tax Returns, all PFICs owned by US persons were required to meet a new annual information-filing requirement. Form 8621: Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund must be completed for **each** foreign mutual fund owned during the tax year, when the aggregate ownership at the end of the year exceeds $25,000 ($5,000 indirect ownership) (exceptions apply), even if no tax would be computed.

If this form is required, failure to file it creates a situation where the tax return to which it pertains remains open to IRS examination for an indefinite period of time.

There are several options available as far as taxation of PFICs is concerned and how they are reported on the tax return. Your tax specialist can review these with you, and can assist you in choosing the option that best fits your situation.

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