international tax planning and reporting requirements

Foreign-earned income exclusions and foreign tax credits can significantly reduce the U.S. tax liability incurred on foreign-source income and help to avoid double taxation. Complex reporting is required for U.S. persons owning foreign assets including bank accounts and other financial investments.

EisnerAmper

IMPACT OF THE TAX CUTS AND JOBS ACT

The TCJA of has had a significant impact in the international tax arena. Most notably, there was a mandatory one-time repatriation of offshore foreign earnings held in a specified foreign entity that impacted (or will impact) calendar 2017 and FYE 2018 taxpayers. All U.S. shareholders with at least 10% ownership in a specified foreign entity are required to include their share of the offshore earnings and profits which have not previously been taxed in the U.S. Only a portion of the foreign earnings are taxable based on the applicable percentage. U.S. shareholders will be allowed a 77.1% deduction for non-cash amounts and a 55.7% reduction for cash amounts. The effective tax rate will ultimately depend on the U.S. shareholder's tax bracket. The repatriation amount was determined as of November 2, 2017 or December 31, 2017; whichever period has the greater amount, and the income was included in the U.S. shareholder's 2017 tax return. Please note, that for fiscal year specified foreign corporations (i.e., FYE in 2018) there may be an additional repatriation of offshore earnings and profits to U.S. shareholders. At the election of the taxpayer, the tax can still be paid over an eight-year period.

Starting with the 2017 tax year, there is a new filing requirement for foreign-owned U.S. disregarded entities. If a foreign person (which includes individuals, partnerships and corporations) owns 100% of a U.S. LLC, it will effectively be treated as disregarded. Such entities are now required to file a pro forma Form 1120 with the Form 5472 attachment. This filing requirement is in addition to filing Form 1120-F. The pro forma 1120 cannot be filed electronically. It is due April 15, 2019 and can be extended. Reportable transactions between the U.S. LLC and its foreign owner include contributions and distributions between the two, and would certainly include the setup and closure of the LLC. There are onerous penalties for non-filing.

FOREIGN TAX ISSUES

Multinational clients with cross-border income from employment and investments are in today's mainstream. Many taxpayers are discovering that they are subject to taxation and/or reporting in both U.S. and foreign jurisdictions. Not all U.S. citizens and resident aliens are aware of their obligation to report their worldwide income to the IRS. As a result, the U.S. continues to pursue U.S. persons who fail to report income and file certain tax forms. These complex issues not only impact you if you are on an overseas assignment or retired abroad, but have broad reaching implications even if you have never left the U.S. For instance, these issues arise if you invest in hedge funds, private equity funds, and other entities that own interests in foreign operating businesses or invest in foreign securities or have foreign retirement plans. Even holding cash in a foreign bank can trigger a reporting requirement.

tax tip

26 TAX BENEFITS OF THE FOREIGN-EARNED INCOME AND HOUSING EXCLUSIONS

Your company sent you to work in Dubai in 2018 for several years, so you qualify as a bona fide resident of the UAE in 2018. Assume you earn $500,000 per year and your company reimburses you for $125,000 of housing costs which are taxable to you. You would be able to exclude the following income from your U.S. income tax return:

- $103,900 of your salary.
- $40,550 of the housing expense reimbursements.

The maximum 2018 foreign earned income exclusion is $103,900, regardless of which foreign country you are working in. The housing exclusion is based on which country and city you are living in (see Chart 13 for some of the more common foreign cities).

Dubai is considered to be an expensive city to live in, so the annual housing exclusion amount is $57,174. Of this amount, you are not eligible to exclude $45.55 per day, or $16,624 for a full year. Therefore, your 2018 housing exclusion will be $40,550 ($57,174 - $16,624). When added to your foreign earned income exclusion of $103,900, you can exclude a total of $144,450.

Therefore, you will be taxed in the U.S. on $480,550 related to your employment in Dubai ($500,000 compensation plus $125,000 housing cost reimbursements less the exclusions of $144,450).

Note: *Although the UAE does not impose an income tax, in this example, if you paid income tax to a country that imposes a tax, you may also be eligible to receive a foreign tax credit against the U.S. tax imposed on the remaining income. However, only 76.89% of these taxes will be allowable as a foreign tax credit that can offset your U.S. income tax (i.e., only $480,550 of the total $625,000 of income will be subject to tax: $480,550 divided by $625,000 is 76.89%).*

As you can see, your foreign housing exclusion might be limited depending on where you live. In order to see the differences in limits for housing deductions in 2018, see Chart 13 on the next page.

chart 13

FOREIGN HOUSING EXCLUSIONS

The amount of foreign housing exclusions costs that you can exclude from your 2018 U.S. income tax return depends on both the country and city you are living in. Below are listed the maximum amounts you can exclude for some common foreign cities, before the adjustment for the daily living cost of $45.55 per day, or $16,624 for a full year.

Country	City	Maximum Annual Housing Exclusion
Canada	Toronto	$ 46,700
China	Hong Kong Beijing	114,300 71,200
France	Paris	73,600
Germany	Berlin	44,100
India	New Delhi	56,124
Italy	Rome	49,000
Japan	Tokyo	89,000
Russia	Moscow	108,000
Switzerland	Zurich	39,219
United Arab Emirates	Dubai	57,174
United Kingdom	London	72,600

This chapter is intended to provide an overview of the income exclusions, foreign tax credits, reporting requirements, and elections involving foreign employment and investments.

Significant legislation enacted in 2010 (the "HIRE Act") imposed a U.S. withholding regime for U.S. income earned by non-U.S. persons and tightened the reporting requirements for offshore accounts and entities set up in foreign jurisdictions. This provision of the HIRE act is the Foreign Account Tax Compliance Act, also known as FATCA. FATCA requires that certain foreign financial institutions play a key role in providing U.S. tax authorities greater access into U.S. taxpayers' foreign financial account information. See FATCA section below.

Through the creation of the FATCA regime, the U.S. has inspired a movement towards greater global tax transparency; similar to the FATCA compliance regime, banks and other investment institutions of foreign nations will have significant additional reporting responsibilities.

FOREIGN-EARNED INCOME EXCLUSION AND FOREIGN HOUSING EXCLUSION/ DEDUCTION

In general, the worldwide income of a U.S. citizen or resident who is working abroad is subject to the same income tax and return filing requirements that apply to U.S. citizens or residents living in the U.S. However, if you are working abroad, you may qualify for one or more special tax benefits:

- Exclude up to $103,900 of foreign-earned income in 2018 and $105,900 in 2019.

- Either (a) exclude part, or all, of any housing income reimbursements you receive or (b) deduct part, or all, of any housing costs paid (i.e., for taxpayers having salary or self-employment earnings).

- Claim a foreign tax credit against your U.S. tax liability for income taxes you pay or accrue to a foreign country, or if more beneficial, take an itemized deduction for the taxes paid.

- Reduce your overall tax liability under tax treaties that the U.S. has with foreign countries.

- If eligible, claim exemption from paying social security tax in the foreign country, based on a Totalization Agreement the U.S. has with the foreign country. Totalization Agreements are essentially "treaties that cover social security taxes" designed to eliminate dual coverage for the same work. You will be required to pay U.S. Social Security and Medicare tax on such income.

To qualify for the foreign-earned income and the foreign housing exclusions, you must establish a tax home in a foreign country and meet either the bona fide residence or physical presence test, defined below:

Bona fide residence test
To qualify under this test, you must establish residency in a foreign country for an uninterrupted period that includes an entire calendar year. Brief trips outside the foreign country will not risk your status as a bona fide resident, as long as the trips are brief and there is intent to return to the foreign country.

Physical presence test
This test requires you to be physically present in a foreign country for at least 330 full days in a consecutive 12-month period, but not necessarily a calendar-year period.

Planning Tip: *If you pay no foreign tax or the effective tax rate in the foreign jurisdiction is lower than the U.S. effective tax rate, claiming the exclusion will generally be more beneficial.*

On the other hand, if the foreign jurisdiction imposes tax at a higher effective rate than the U.S., it is likely that the U.S. tax on the foreign-earned income will be completely offset by the foreign tax credit regardless of whether the exclusion is claimed.

You should consider whether foregoing the exclusion may result in a lower utilization of foreign tax credits in the current year so that a larger amount of foreign tax credits can be carried back or forward for utilization in other years. You should also consider whether the foreign-earned income exclusion and housing exclusion election will mitigate your state tax burden to the extent that you remain taxable on worldwide income in the state of residency.

Otherwise, in certain circumstances, it may be more beneficial to forego the exclusion in favor of claiming only a greater foreign tax credit.

Claiming the exclusion is a binding election. Once you have claimed the exclusion, you will be required to continue to claim it in all future years. If you revoke the election, you will not be allowed to claim the exclusion again until the sixth tax year after the year of revocation unless you receive permission from the IRS. If you have claimed the exclusion in the past, the benefit of revoking the exclusion must be weighed against the possible ramifications of being unable to re-elect the exclusion for five years. There is no downside of forgoing the exclusion if you have never claimed it in the past.

Note: *For Americans residing overseas, the foreign-earned income exclusion is not considered when calculating the applicable thresholds for either the 3.8% Medicare Contribution Tax on net investment income or the .9% Additional Medicare Tax on earned income.*

FOREIGN TAX CREDIT

A foreign tax credit may be claimed by U.S. citizens, resident aliens, and in certain cases by nonresident aliens. Typically states do not allow foreign taxes to offset state income tax liabilities. An exception to this includes New York State, which allows a credit for certain Canadian provincial income taxes. Unlike the exclusions discussed above, you do not need to live or work in a foreign country in order to claim the foreign tax credit. You may be eligible for the credit if you paid or accrued foreign taxes in the tax year. Common examples of foreign-sourced income that may generate foreign tax credits include dividends paid by foreign corporations, including those paid on your behalf through a mutual fund, and foreign business income earned by a flow-through entity.

You are entitled to claim either a tax credit or an itemized deduction for taxes paid to foreign countries. Though not always the case, the tax credit is typically more beneficial since it can reduce your U.S. federal tax liability on a dollar-for-dollar basis.

Generally, only foreign income taxes qualify for the foreign tax credit. Other taxes, such as foreign real and personal property taxes, do not qualify.

- Taxes paid on income excluded from U.S. gross income (e.g., foreign-earned income exclusion or a treaty-based return position taken).

- Taxes paid to the countries that participate in certain international boycotts.

- Taxes of U.S. persons controlling foreign corporations and partnerships if certain annual international returns are not filed.

- Certain taxes paid on foreign oil-related, mineral, and oil and gas extraction income.

This deduction is virtually eliminated for 2018 (and through 2025) under the Tax Cuts and Jobs Act.

Your ability to claim a credit for the full amount of foreign taxes paid or accrued is limited based on a ratio of your foreign-sourced taxable income to your total taxable income. This ratio is applied to your actual tax (excluding the 3.8% Medicare Contribution Tax on net investment income) before the credit to determine the maximum amount of the credit that you can claim. If you are not able to claim the full amount of the credit in the current year, you must carry the excess back to the immediately preceding tax year and if not utilized in the prior year, the remaining credit is carried forward for the next ten tax years, subject to a similar limitation in those years.

The credit is calculated for each separate type of foreign-source income. In other words, foreign taxes paid on dividends are subject to a separate limitation than foreign taxes paid on income from salary or an active trade or business. Foreign-source income is generally classified into two different baskets for determining the allowable credit:

- **Passive income:** This category includes dividends, interest, rents, royalties, and annuities.

- **General limitation income:** This category includes income from foreign sources which does not fall into the passive separate limitation category and generally is income earned from salary, pensions or an active trade or business.

In addition you are required to maintain a separate foreign tax credit limitation basket for each country in which income is resourced under an income tax treaty. This provision applies to income classified as U.S. source income under U.S. tax law, but treated as foreign-source under an income tax treaty.

EXPATRIATION EXIT TAX

If you plan on giving up your U.S. citizenship or relinquishing your U.S. legal permanent residency status ("green card") and are considered a "covered expatriate," you will pay an income tax at the capital gains rate as though you had sold all of your assets at their fair market value on the day before the expatriation date. The 3.8% additional Medicare Contribution Tax on net investment income may apply in the case of a "covered expatriate" who is subject to the exit tax. Any gain on the deemed sale in excess of a floor of $713,000 for 2018 (estimated at $725,000 for 2019) is immediately taxed ("mark-to-market tax"). Losses are taken into account and the wash sale rules do not apply. An election can be made to defer the tax on the deemed sale until the asset is actually sold (or the taxpayer's death, if sooner) provided a bond or other security is given to the IRS. Deferred compensation items and interests in non-grantor trusts are not subject to the tax but are generally subject to a 30% withholding tax on distributions to the expatriate. IRAs and certain other tax-deferred accounts are treated as if they were completely distributed on the day before the expatriation date (early distribution penalties do not apply).

Former long-term residents who held a U.S. green card for any-time during eight out of the last 15 years and all U.S. citizens are subject to the expatriation regime if they:

- Had average annual net income tax liability for the five years ending before the date of expatriation or termination of residency in excess of an annual ceiling, which is $165,000 for 2018 and $168,000 (estimated) for 2019;

- Had a net worth of $2 million or more when citizenship or residency ended; or

- Failed to certify compliance under penalties of perjury on Form 8854, Initial and Annual Expatriation Statement, with all U.S. federal tax obligations for the five tax years preceding the date of expatriation.

A U.S. citizen or resident will have to pay tax on a gift or bequest received from an individual who had expatriated after June 17, 2008. The tax does not apply to the extent that the gift or bequest during the year is within the annual gift tax exclusion ($15,000 for 2018 and 2019). The tax does not apply if the transfer is reported on a timely filed gift tax return or estate tax return or to transfers that qualify for the marital or charitable deductions. The value of a transfer not covered by an exception is taxable to the recipient at the highest rate on taxable gifts, which is currently 40%.

U.S. INCOME TAXATION OF NONRESIDENT INDIVIDUALS

Residents are taxed differently than nonresidents. Resident aliens are taxed on worldwide income at graduated tax rates much the same as a U.S. citizen. A nonresident alien, however, is taxed at graduated rates only on income that is effectively connected with a U.S. trade or business or at a flat 30% rate on U.S.-source income that is not effectively connected with a U.S. trade or business (unless a lower income tax treaty rate applies). Nonresident taxpayers are specifically exempt from the 3.8% Medicare Contribution Tax on net investment income.

A foreign national is generally deemed a resident alien of the U.S. if one of the two following tests is met:

- Lawful permanent residence (green card test); or
- Substantial presence test.

If an individual is physically present in the U.S. for at least 31 days during 2018 and has spent at least 183 days during the period of 2018, 2017, and 2016 counting all of the days of physical presence in 2018, but only one-third of the days of presence in 2017, and only one-sixth of the number of days in 2016, the individual will be deemed a resident for U.S. tax purposes.

Except as noted below, you are treated as being present in the U.S. on any day that you are physically present in the country at any time during the day. Exceptions include days spent in the U.S. for the following circumstances:

1. Days you regularly commute to work in the U.S. from a residence in Canada or Mexico.
2. Days you were in the U.S. for less than 24 hours when you were traveling between two places outside the U.S.
3. Days you were temporarily in the U.S. as a regular crew member of a foreign vessel engaged in transportation between the U.S. and a foreign country or a possession of the U.S. unless you otherwise engaged in trade or business on such a day.
4. Days you were unable to leave the U.S. because of a medical condition or medical problem that arose while you were in the U.S.
5. Days you were an exempt individual (e.g., foreign government-related individual, teacher or trainee, student or a professional athlete competing in a charitable sporting event).

Note: *If you qualify to exclude days of presence in the U.S. because you were an exempt individual (other than a foreign government-related individual) or because of a medical condition or medical problem, you must file Form 8843, Statement for Exempt Individuals and Individuals with a Medical Condition. In addition, there are certain elections available to nonresidents who move to the U.S. that could minimize global taxation.*

Even though you may otherwise meet the substantial presence test, you will not be treated as a U.S. resident for 2018 if you do not have a green card and:

- You were present in the U.S. for fewer than 183 days during the calendar year in question,
- You establish that during the calendar year, you had a tax home in a foreign country, and
- You establish that during the calendar year, you had a closer connection to one foreign country in which you had a tax home than to the U.S., unless you had a closer connection to two foreign countries.

You will be considered to have a closer connection to a foreign country other than to the U.S. if you or the IRS establishes that you have maintained more significant contacts with the foreign country than with the U.S.

IRS Form 8840, Closer Connection Exception Statement for Aliens, will need to be submitted with your U.S. nonresident income tax return for the year in which you meet the substantial presence test and you are exempt from it because you also meet the closer connection test.

Alternatively, you may be considered a nonresident if you also would qualify as a resident of your home jurisdiction under the tie breaker clause of an income tax treaty with the U.S.

U.S. REPORTING REQUIREMENTS FOR NONRESIDENT ALIENS

Form 1040NR/1040NR-EZ

This form is used by nonresident aliens of the U.S. to annually report U.S.-source income and the payments of U.S. tax, made either through withholding by the payor or through estimated tax payments. The U.S. tax liability for the year is computed and any tax due in excess of payments made during the year is remitted to the U.S. Treasury. A U.S. nonresident may also be subject to state income tax on the income earned in one or more states.

Foreign nationals, nonresident aliens and other taxpayers who

have filing or payment obligations under U.S. law and are not eligible for a social security number are required to obtain an Individual Taxpayer Identification Number ("ITIN"). The IRS will only issue ITINs when applications include original documentation (e.g., passports and birth certificates) or copies of these documents that have been certified by the issuing agency. There are certain exceptions for families of military personnel and for persons who have certain types of income subject to withholding (e.g., pensions). ITINs issued after 2012 may have a five-year expiration period.

Note: *When reporting as a U.S. nonresident, residents of another country under the provision of a treaty will be required to file Form 1040NR/1040NR-EZ and include applicable forms to report interests in foreign entities, (e.g., Forms 8621, 5471, and 8865) and financial accounts (see below).*

Form 1042-S
If you are a nonresident of the U.S. and receive income from U.S. sources, you will receive Form 1042-S. This is the annual information return prepared by the payor to report your name, address, amount and type of income paid and any taxes withheld.

This form is normally distributed no later than March 15 of the following year. If the recipient of the income is a U.S. person, a Form 1099 would be issued instead; Forms 1099 are generally due to be received by U.S. persons no later than January 31 of the following year. Information on Form 1042-S may also be reported to the tax authorities in the recipients' country of residence.

Form W-8 BEN
This form is provided by a nonresident alien to a payor to certify the recipient's residency status as beneficial owner of the income. If applicable, this form should also be completed to claim the benefits of an income tax treaty.

Form W-8 BEN-E
This form is provided by a foreign entity to document its foreign status to a payor to certify the recipient's status as beneficial owner of the income. If applicable, this form should also be completed to claim the benefits of an income tax treaty.

Caution: *If you give the payor the wrong form you will likely receive unnecessary (and avoidable) correspondence from the IRS.*

FOREIGN REPORTING REQUIREMENTS FOR U.S. CITIZENS AND RESIDENTS

There are many IRS tax forms that must be completed and attached to your tax return to disclose foreign holdings and to make elections that could prove valuable to you. If you have investments in foreign companies, whether held directly by you or through a pass-through entity such as an investment partnership or hedge fund, your reporting requirements increase. These requirements place an additional burden on the amount of information you must include with your U.S. income tax return. Failure to do so could result in substantial penalties and the loss of beneficial tax elections. Some of the most common of these forms are:

- Form 114, Report of Foreign Bank and Financial Accounts.
- Form 8621, Return by a Shareholder of a Passive Foreign Investment Company (PFIC) or Qualified Electing Fund (QEF).
- Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation.
- Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships.
- Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations.
- Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts.
- Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner.
- Form 8938, Statement of Foreign Financial Assets.

FORM 114 — REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS ("FBAR")

If you are a U.S. person (including a corporation, partnership, exempt organization, trust or estate) and have a financial interest in or signature authority over a foreign financial account, you may be subject to FBAR reporting.

The FBAR must be filed on an annual basis if you have a financial interest in or signature authority over one or more financial accounts in a foreign country with an aggregate value exceeding $10,000 at any time during the year. Beginning with the 2016 FBAR and forward, the due date for this form is April 15 of the following year and a six-month extension of this deadline may be granted. FinCEN automatically extended the due date for all FBARs until October 15 for 2016 and 2017 returns. Currently it is not known whether automatic extensions will apply for 2018 tax returns.

Note: *The requirement for submission of both new and amended filings for all years must be done online and CPAs can file FBAR*

forms on behalf of their clients as long as they have a document granting them that authority. If amending an FBAR filing, the prior BSA Identification number must be provided from the original filing.

Financial accounts include banks, securities, derivatives, foreign mutual funds or other financial accounts (including any savings, demand, checking, deposit, annuity, or life insurance contract other than term insurance or other account maintained with a financial institution). The IRS continues to suspend the reporting of offshore commingled funds, such as hedge funds and private equity funds.

A financial interest in an account includes being the owner of record or having legal title, even if acting as an agent, nominee, or in some other capacity on behalf of a U.S. person. Taxpayers who have signatory authority over accounts owned by others (e.g., minor children, parents, etc.) are also reportable. A financial interest also includes an account held by a corporation in which you own, directly or indirectly, more than 50% of the total voting power or value of shares; a partnership in which you own an interest of more than 50% in the capital or profits; or a trust as to which you or any other U.S. person has a present beneficial interest in more than 50% of the assets or receives more than 50% of the current income.

In the case of a nonwillful failure to file the FBAR, the IRS may impose a maximum penalty of $10,000 per account. Procedures issued by the IRS in 2015 limit the maximum penalty imposed where there is willfulness. The memo specifically instructs examiners to calculate a single penalty for all years combined and then allocate it to each year. The single penalty is 50% of the highest aggregate balance in any of the years under examination. Criminal penalties could also be assessed for willful violations.

Note: *In previous years the maximum penalty was the greater of $100,000 or 50% of the highest balance in the account during the year.*

OFFSHORE VOLUNTARY DISCLOSURE PROGRAMS

Since 2009 the IRS has offered various programs designed for taxpayers to voluntary disclose previously unreported foreign income or assets. Two of the programs which focus on disclosure of foreign assets are the Offshore Voluntary Disclosure Program ("OVDP") and the Streamlined Filing Compliance Procedure ("SFCP"). Both programs provide an opportunity for taxpayers to come forward and disclose unreported foreign income and file information returns while paying a reduced penalty or, in some cases, no penalty at all. In the case of the OVDP, the individual may also avoid criminal prosecution. In 2014 the IRS announced important changes to both programs. Specifically, the IRS imposed stricter requirements and potentially higher penalties for taxpayers participating in the OVDP, and expanded the original SFCP program in taxpayer friendly ways to include taxpayers residing both in the U.S. and abroad.

Note: *The OVDP program was closed on September 28, 2018 with no replacement program created. The SFCP program remains open, but can close at any time. Thus, taxpayers who can benefit from participating in the SFCP program should act promptly.*

FORM 8621, RETURN BY A SHAREHOLDER OF A PASSIVE FOREIGN INVESTMENT COMPANY ("PFIC") OR QUALIFIED ELECTING FUND ("QEF")

U.S. persons who invest in a foreign corporation which is a PFIC are subject to the harsh PFIC regime. Unless a QEF election or mark-to-market ("MTM") election is made they will pay tax on gains from the sale of the investment or on certain distributions from the PFIC ("excess distributions"). Also if neither of these two elections is made, upon disposition of all or some of the PFIC stock or certain distributions ("excess distributions") the harsh PFIC rules will also apply. These rules require a ratable allocation of any gain over the years during which the shares were held and that gain is taxed at the highest rate on ordinary income in effect for each of the years involved, rather than the beneficial long-term capital gains rate in the year of disposition. An interest charge is also imposed on the tax, and begins running from the period to which such gain is allocated. In certain situations, this tax can exceed 100% of the gain (ergo, "harsh").

Classification as a PFIC occurs when 75% or more of the corporation's income is passive or when more than 50% of the corporation's assets generate passive income. Passive income includes, but is not limited to, interest, dividends, and capital gains.

U.S. shareholders who make the QEF election on Form 8621 are required to annually include in income the pro rata share of the ordinary earnings and net capital gains of the corporation, whether or not distributed, thus avoiding the onerous PFIC tax.

Alternatively, a shareholder of a PFIC may make an MTM election on Form 8621 for marketable PFIC stock. If the election is made, the shareholder includes in income each year an amount equal to the excess, if any, of the fair market value of the PFIC stock as of the close of the tax year over the shareholder's adjusted basis in the stock; or deducts the excess of the PFIC's adjusted basis over its fair market value at the close of the tax year (the

deduction is limited to cumulative income that was included in previous years).

If the election is made, the PFIC rules do not apply. Amounts included in income or deducted under the MTM election, as well as gain or loss on the actual sale or other disposition of the PFIC stock, are treated as ordinary income or loss.

U.S. persons (i.e., individuals, corporations, partnerships, trusts, and estates) owning PFICs are required to file Form 8621 regardless of whether an excess distribution has occurred or an election has been made. This applies to U.S. shareholders who own shares directly and indirectly who are at the lowest tier of a chain of companies.

Ownership of PFIC stock through another U.S. taxpayer may also trigger reporting in certain instances. U.S. persons who are required to include an amount in income under the QEF or MTM regimes for PFIC stock held through another U.S. taxpayer are not required to file if another shareholder through which the U.S. person holds the PFIC stock timely files. The filing applies to domestic estates, non-grantor trusts and U.S. owners of domestic or foreign grantor trusts that own PFIC stock.

U.S. persons who are beneficiaries of foreign estates and foreign non-grantor trusts that have made QEF or MTM elections are required to file, while those beneficiaries of domestic estates or trusts are only required to file if the estate or trust fails to file the form. U.S. beneficiaries are required to report in any case in which the beneficiary receives an excess distribution or recognizes gains treated as excess distributions.

A limited filing exception applies for certain shareholders with respect to an interest owned in a PFIC for which the shareholder is subject to PFIC tax where no QEF or MTM election is in effect. The exception applies only if the shareholder is not subject to PFIC tax with respect to any excess distributions or gains treated as excess distributions and either (a) the aggregate value of all PFIC stock owned by the shareholder at the end of the tax year of the shareholder does not exceed $25,000 ($50,000 for joint filers), or (b) the PFIC stock is owned by the shareholder through another PFIC, and the value of the shareholder's proportionate share of the upper-tier PFIC interest in the lower-tier PFIC does not exceed $5,000.

FORM 926, RETURN BY A U.S. TRANSFEROR OF PROPERTY TO A FOREIGN CORPORATION

Form 926 is used to report certain transfers of tangible or intangible property to a foreign corporation. While there are certain exceptions to the filing, generally the following special rules apply to reportable transfers:

- If the transferor is a partnership, the U.S. partners of the partnership, not the partnership itself, are required to report the transfer on Form 926 based on the partner's proportionate share of the transferred property.

- If the transfer includes cash, the transfer is reportable on Form 926 if immediately after the transfer the person holds, directly or indirectly, at least 10% of the total voting power or the total value of the foreign corporation, or the amount of cash transferred by the person to the foreign corporation during the 12-month period ending on the date the transfer exceeds $100,000.

The penalty for failure to comply with the reporting requirements is 10% of the fair market value of the property at the time of the transfer, limited to $100,000 if the failure to comply was not due to intentional disregard.

FORM 8865, RETURN OF U.S. PERSONS WITH RESPECT TO CERTAIN FOREIGN PARTNERSHIPS

Form 8865 is required to report information with respect to controlled foreign partnerships, transfers to foreign partnerships, or acquisitions, dispositions, and changes in foreign partnership ownership. A separate Form 8865, along with the applicable schedules, is required for each foreign partnership.

There are four categories which define who is required to file the form and how much information must be provided. The categories are:

- **Category 1:** A U.S. person who owned more than a 50% interest in a foreign partnership at any time during the partnership's tax year.

- **Category 2:** A U.S. person who at any time during the tax year of the foreign partnership owned a 10% or greater interest in the partnership while the partnership was controlled by U.S. persons each owing at least 10% interest. However, if there was a Category 1 filer at any time during that tax year, no person will be considered a Category 2 filer.

- **Category 3:** A U.S. person, including a related person, who contributed property during that person's tax year to a foreign partnership in exchange for an interest in the partnership, if that person either owned directly or indirectly at least a 10% interest in the foreign partnership immediately after the contribution, or

the value of the property contributed by such person or related person exceeds $100,000. If a domestic partnership contributes property to a foreign partnership, the partners are considered to have transferred a proportionate share of the contributed property to the foreign partnership. However, if the domestic partnership files Form 8865 and properly reports all the required information with respect to the contribution, its partners will generally not be required to report the transfer. Category 3 also includes a U.S. person that previously transferred appreciated property to the partnership and was required to report that transfer under IRC Sec. 6038B, if the foreign partnership disposed of such property while the U.S. person remained a partner in the partnership.

- **Category 4:** A U.S. person who had acquired or disposed of or had a change in proportional interest may be required to report under this category if certain requirements are met.

A penalty of $10,000 can be assessed for failure to furnish the required information within the time prescribed. This penalty is applied for each tax year of each foreign partnership. Furthermore, once the IRS has sent out a notification of the failure to report the information, an additional $10,000 penalty can be assessed for each 30-day period that the failure continues, up to a maximum of $50,000 for each failure.

FORM 5471, INFORMATION RETURN OF U.S. PERSONS WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS

Form 5471 is used to satisfy the reporting requirement for U.S. persons who are officers, directors, or shareholders in certain foreign corporations. You will be required to file this form if you meet one of the following tests (Category 1 has been repealed):

- **Category 2:** You are a U.S. person who is an officer or director of a foreign corporation in which a U.S. person has acquired stock that makes him/her a 10% owner with respect to the foreign corporation, or acquired an additional 10% or more of the outstanding stock of the foreign corporation.

- **Category 3:** You are a U.S. person who acquires stock in a foreign corporation which, when added to any stock owned on the date of acquisition or without regard to stock already owned, meets the 10% stock ownership requirement with respect to the foreign corporation, or

  - You are a person who becomes a U.S. person while meeting the 10% stock ownership requirement with respect to the foreign corporation, or

  - You are a U.S. person who disposes of sufficient stock in the foreign corporation to reduce your interest to less than the 10% stock ownership requirement.

- **Category 4:** You are a U.S. shareholder who owns more than 50% of the total combined voting power of all classes of stock entitled to vote or more than 50% of the total value of the stock in a foreign corporation at any time during any tax year of the foreign corporation.

- **Category 5:** You are a U.S. shareholder who owns stock in a controlled foreign corporation ("CFC") at any time and who owns the stock on the last day of that year. A CFC is defined as a foreign corporation that has U.S. shareholders (counting only those with at least a 10% interest) that own on any day of the tax year of the foreign corporation more than 50% of the total combined voting power of all classes of its voting stock, or the total value of the stock of the corporation.

Note: *Certain constructive ownership rules apply in determining stock ownership for these purposes.*

The same penalties that apply for failure to file Form 8865 also apply to Form 5471 (see the discussion in the previous section). The information required to properly complete Form 5471 can be extensive and at times difficult to obtain.

One of the issues faced by U.S. multinationals is that profits earned by foreign subsidiaries can often be subjected to U.S. federal income tax, even if the cash that represents those earnings is not repatriated. This is the result of the wide variety of anti-deferral rules introduced by Congress over the years.

Most notably, Subpart F was designed to tax the types of income that could be easily moved into low tax jurisdictions, such as dividends, interest, rents and royalties. The anti-deferral rules aim to subject such income to federal tax in the year in which the subsidiary earns it. The CFC look-through rule provides that certain dividends, interest, rents and royalties paid between related parties are excluded from the calculation of Subpart F. Accordingly the look-through rule operates to reduce the global effective tax rate for many multinational companies.

Observation: *The look-through rule for related parties has been permanently extended as a result of PATH.*

New for 2018, Global Low Taxed Intangible Income ("GILTI") is an additional regime designed to capture offshore income that Subpart F does not. U.S. shareholders of a CFC are required to include their share of GILTI into their gross income. GILTI is a complex new area of international tax law with very little exclusions.

Another oft-encountered rule under the Subpart F regime is the rule which limits the CFC's investment in the U.S. Under this provision if a CFC extends a loan to its U.S. shareholder or a party related to its U.S. shareholder, the loan is deemed a dividend for U.S. taxpayers. Included in the definition of a loan are certain trade receivables as well as using the CFC as collateral or as a guarantor to obtain a bank loan in the U.S.

Note: *Proposed regulations under IRC Sec. 956 have been issued by the IRS discussing new rules in which a Corporation would benefit from the dividend received deduction in computing their IRC Sec. 956 inclusion. However, this benefit will not apply to individuals.*

FORM 3520, ANNUAL RETURN TO REPORT TRANSACTIONS WITH FOREIGN TRUSTS AND RECEIPT OF CERTAIN FOREIGN GIFTS AND FORM 3520-A, ANNUAL INFORMATION RETURN OF FOREIGN TRUST WITH A U.S. OWNER

U.S. persons who either create a foreign trust, receive distributions from a foreign trust, or receive gifts or bequests from foreign persons are required to file Form 3520.

A foreign trust is defined as a trust in which either a court outside of the U.S. is able to exercise primary supervision over the administration of the trust or one or more non-U.S. persons have the authority to control all substantial decisions of the trust.

The information return must be filed in connection with the formation of a foreign trust, the transfer of cash or other assets by the settlor or grantor to a foreign trust, and the receipt of any distributions by a U.S. beneficiary from a foreign trust. Any uncompensated use of foreign trust property (e.g., real estate or personal property) by a U.S. grantor, U.S. beneficiary, or any related person is treated as a distribution to the grantor or beneficiary equal to the fair market value of the use of the property and must be reported. The use or loan of trust property will not be considered a distribution to the extent the loan is repaid with a market rate interest or the user makes a payment equal to the fair market value of such use within a reasonable time frame.

Gifts or bequests that you receive in the form of money or property from a non-resident alien (including a foreign estate) that is valued in the aggregate at more than $100,000 annually and gifts in excess of $16,076 in 2018 (Estimated at $16,431 for 2019) from a foreign corporation or foreign partnership are also reported on Form 3520.

Form 3520 must be filed by the due date of your individual income tax return, including extensions. The failure to do so may subject you to a penalty of 35% of the gross value of any property transferred to the trust, 35% of the gross value of the distributions received from the trust, or 5% of the amount of certain foreign gifts for each month for which the gift goes unreported (not to exceed 25% of the gift).

In addition to the filing requirements of Form 3520, there is also a requirement to file Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner, which is an annual information return of a foreign trust with at least one U.S. owner and which is considered a grantor trust. If you are a U.S. person who directly or indirectly transfers property to a foreign trust, the trust is presumed to have a U.S. beneficiary and is considered a grantor trust unless you can demonstrate that under the terms of the agreement, no income or corpus of the trust can be paid or accumulated for the benefit of a U.S. person. As the U.S. owner, you are responsible for ensuring that the foreign trust annually furnishes certain information to the IRS and the other owners and beneficiaries of the trust.

Form 3520-A must be filed by March 15 after the foreign trust's tax year, in the case of a calendar-year trust. A six-month extension can be requested on IRS Form 7004.

FORM 8938, STATEMENT OF FOREIGN FINANCIAL ASSETS

U.S. citizens or resident aliens filing joint returns who hold, at the end of the year, an aggregate of more than $100,000 (or $50,000 for single taxpayers) in certain foreign assets (e.g., a foreign financial account, an interest in a foreign entity, or any financial instrument or contract held for investment that is held and issued by a foreigner) will be required to report information about those assets on Form 8938. Those taxpayers filing jointly who hold $150,000 (or $75,000 for single) in foreign assets at any time during the year also have a filing obligation regardless of whether the end-of-year threshold is met. This requirement is in addition to the FBAR reporting. Form 8938 is part of the annual income tax return, whereas the FBAR is filed separately.

Beginning after December 31, 2015, certain domestic corporations, partnerships, and trusts that are considered formed or availed of for the purpose of holding, directly or indirectly, specified foreign financial assets (special domestic entities) must file Form 8938 if the total value of those assets exceeds $50,000 on the last day of the tax year or $75,000 at any time during the tax year.

For U.S. citizens or resident aliens living outside of the U.S. the filing thresholds are increased to $400,000 (or $200,000 for single taxpayers). Also, individuals not required to file a U.S. income tax return for the tax year are not required to file Form 8938 even if the aggregate value of the specified foreign financial assets

is more than the appropriate reporting threshold and there is a reporting exception for foreign financial assets reported on certain information returns.

Noncompliance with these rules for any tax year could result in a failure-to-file penalty of $10,000 and continuing failure to file penalties up to $50,000. In addition, a 40% understatement penalty for underpayment of tax as a result of a transaction involving an undisclosed specified foreign financial asset can be assessed; criminal penalties may also apply.

For tax returns filed after March 18, 2010, the statute of limitations for assessing tax with regard to cross-border transactions or for certain foreign assets will be extended for three years from the date certain informational reporting is submitted related to the transaction or the asset if the failure to report was due to reasonable cause and not willful omission. If an omission is in excess of $5,000 related to a foreign financial asset, the statute of limitations will be extended from three years to six years and would not begin to run until the taxpayer files the return disclosing the reportable foreign asset.

Observation: *The definition of a reportable foreign asset is much broader than under the FBAR rules and includes interests in offshore hedge funds, private equity funds, and real estate holding companies.*

FOREIGN ACCOUNT TAX COMPLIANCE ACT — FATCA

Beginning July 1, 2014, foreign financial institutions are required to report directly to the IRS certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. To properly comply, a foreign financial institution was required to enter into a special agreement with the IRS by June 30, 2014. A participating institution will be required to implement certain due diligence procedures prior to opening an account, identify U.S. account holders who have opened accounts or after the effective date of the agreement, and have certain procedures for pre-existing accounts. The U.S. account holder will need to provide the institution with a Form W-9 to identify the status as a U.S. person and the institution will report the information to the IRS. Those institutions that do not participate and account owners unwilling to provide information will be subject to a 30% withholding tax on certain U.S.-source payments including interest, dividends and proceeds from the source of securities.